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REPORT TO THE CONGRESS



Russian Wheat Sales And Weaknesses In Agriculture's Management Of Wheat Export Subsidy Program

B-176943

Department of Agriculture

**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

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JULY 9, 1973



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-176943

To the President of the Senate and the
Speaker of the House of Representatives

We have reviewed the Russian wheat sales and Agriculture's management of the wheat export subsidy program. An interim staff report was made available to interested Members of Congress on November 3, 1972, and, at the request of the Chairman, we testified before the Senate Committee on Agriculture and Forestry on March 8, 1973, to present developments up to that point in time.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1951 (31 U.S.C. 67).

We are sending copies to the Director, Office of Management and Budget; the Secretary, Department of Agriculture; the Chairman, Council on Economic Policy; and the Executive Director, Council on International Economic Policy.

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General
of the United States

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BEST DOCUMENT AVAILABLE

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

RUSSIAN WHEAT SALES AND WEAKNESSES
IN AGRICULTURE'S MANAGEMENT OF
WHEAT EXPORT SUBSIDY PROGRAM
Department of Agriculture
B-176943

D I G E S T

WHY THE REVIEW WAS MADE

Several members of the Congress requested that GAO examine the implications of the massive wheat sales to Russia in the summer of 1972 and the Department of Agriculture's management of the subsidy program, including its system of gathering and disseminating foreign agricultural information.

The President announced the signing of an agreement with Russia on July 8, 1972, making credit totaling \$750 million available over a 3-year period for purchasing various U.S. grains. By then Russia was already purchasing U.S. wheat.

Within a few weeks, cash and credit wheat sales to Russia, heavily subsidized by the U.S. Government, approximated \$700 million, the largest private grain sales in U.S. history. Because of the size the sales were historic, but they also focused national attention on Agriculture's administration of the wheat export subsidy program.

Basic information

The wheat export subsidy program began in 1949 to help the United States meet its obligation to export wheat at prices agreed to under the International Wheat Agreement.

The program's major objectives are to generally insure that U.S. wheat is competitive in world markets and to reduce Government wheat inventories.

The Secretary of Agriculture, as Chairman of the Board of Directors of the Commodity Credit Corporation (CCC), decides whether subsidies should be paid. Exporters enter into agreements with CCC to export wheat and, after shipment, submit documentation to support the subsidy claimed. The Assistant Secretary for International Affairs and Commodity Programs makes policy decisions affecting subsidy rates.

The Export Marketing Service establishes daily subsidy rates for five classes of wheat according to protein levels, costs of export, and export periods. These rates apply to all export destinations. The Service has maintained a zero subsidy rate for all types of wheat since September 22, 1972, allowing wheat prices to seek their own levels, but, during the preceding 4 months rates ranged from a few cents to as high as 51 cents a bushel for Hard Winter wheat.

Before its suspension, the program incurred about \$4.3 billion in subsidy costs for the export of about 10.5 billion bushels of U.S. wheat.

There is little doubt that the program has been instrumental in

An export goal of 650 million bushels and a fiscal year 1973 budget estimate of \$67 million in subsidy mushroomed to 1.1 billion bushels in exports and over \$300 million in subsidy. (See p. 14.)

Agriculture needs to establish rules and procedures for transactions involving unusual purchases by state trading monopolies. The unequal bargaining power that exists when a single, fully informed buyer (the Russian state trading agency) confronts several partially informed sellers calls for greater Government-industry cooperation. (See p. 63.)

Speculating in subsidy registrations

Changes made in 1967 to the basic wheat export subsidy program, permitting subsidy registrations at exporters' options, and other program features in effect at the time of the wheat sales to Russia tended to minimize risks and created an environment whereby exporters could make substantial profits. Although Agriculture sought to increase the flexibility for exporters to price U.S. wheat competitively in international markets, the program lacked appropriate administrative controls.

Some exporters making sales in August 1972 registered sales several weeks later at higher subsidy rates. In five examples, CCC paid a total subsidy of about \$604,493. Had exporters been required to register on the dates of sales, the subsidy would have been \$286,188, or \$318,305 less. (See p. 32.)

Export Marketing Service officials

contend there is no evidence that the program had allowed excess profit because of intense competition among exporters.

GAO tested the possible profitability of 50 cases under the subsidy registration procedures. These comparisons, for other than sales to Russia, showed an average differential of 29.8 cents a bushel. GAO's calculation is based on using estimated purchase costs against sale prices plus subsidy on 5.7 million bushels registered. GAO tests indicated that unusual margins were possible under the subsidy registration procedures. (See pp. 33 and 34.)

In another test of 430 September 1972 registrations totaling about 160 million bushels with a subsidy entitlement of \$36 million, GAO's examination of sales contracts showed that most of the sales for which data was available were consummated well after the export subsidy had been suspended. Because the nonsubsidized U.S. export price was competitive in world markets, subsidies were not needed. (See pp. 36 and 37.)

Other management considerations

Carrying-charge payments are intended to cover the estimated costs of owning wheat for future delivery. The subsidy registration date, instead of the sale date, is used to calculate subsidy entitlement. In 28 instances totaling about \$360,000, had the sale contract dates rather than the registration dates determined the carrying-charge subsidies, the payments would have been about \$350,000 less. (See p. 39.)

--Review the legality of export subsidy payments involving sales to foreign affiliates, especially registrations under System I and those recorded before August 1971.

2. For disseminating foreign agricultural information:

--Form a joint Government-business committee representing farmers, processors, distributors, and exporters to identify information needs.

3. If the program review concludes that subsidies are needed:

--Determine the most effective and efficient ways to use subsidies to compete in world markets.

--Provide for periodic evaluation of program effectiveness and efficiency.

--Document the basis and reasoning used in establishing daily subsidies.

--Direct that sales and cost data on wheat transactions be used in establishing and checking the reasonableness of subsidy levels and consider flexible subsidies according to geographic locations and circumstances.

--Better coordinate commercial sales, concessionary credit sales, and sales from CCC inventory into a cohesive wheat export policy having appropriate safeguards on

subsidy payment amounts.

--Consider revising the basis for computing entitlement to the carrying-charge increment.

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Secretary of Agriculture advised that the GAO study will prove useful in helping the Department make program improvements for the future. The Secretary agreed with GAO's major recommendations but took issue with GAO on some other observations and conclusions. The Secretary's comments and GAO's evaluations are presented in appendix I.

MATTERS FOR CONSIDERATION
BY THE CONGRESS

U.S. agriculture's productive capacity has traditionally resulted in surplus stocks which were stored at great expense or exported with subsidy. Although exports are important to achieving U.S. trade objectives, they can have an adverse effect. Recent dramatic changes in the world supply-demand situation surfaced a need for assessing agricultural exports in a broader national context.

Congress should consider requiring that agencies develop definitive ground rules so that expected benefits from exports can be appropriately weighed against their impact on various segments of the domestic economy.

CHAPTER 1

INTRODUCTION

U.S. wheat export sales in fiscal year 1973 are expected to approximate 1.1 billion bushels, the largest annual export in U.S. history. In July and August 1972 sales to Russia, totaling about 440¹ million bushels and valued at about \$700 million, accounted for about 40 percent of the record exports. Although the Secretary of Agriculture viewed the heavily subsidized sales as a major agricultural and national achievement, they were controversial. The large demand placed on U.S. wheat supplies by these and other sales in the period caused the domestic price to rise from about \$1.68 a bushel in July to about \$2.49² a bushel in September 1972. Farmers, farm groups, the communications media, and the Congress questioned whether the Department of Agriculture gave exporters advance information on impending sales to Russia enabling them to purchase wheat at low prices for later delivery at higher subsidized prices. They also questioned whether Agriculture had properly informed farmers and farm groups concerning the prospects for such sales.

Congressional concern resulted in hearings in September 1972 before the House Subcommittee on Livestock and Grains. A number of bills were introduced in the Senate and House. Several individual Members and congressional committees requested that we review Agriculture's management of the wheat export subsidy program, including its system of gathering, analyzing, using, and disseminating foreign agricultural information.

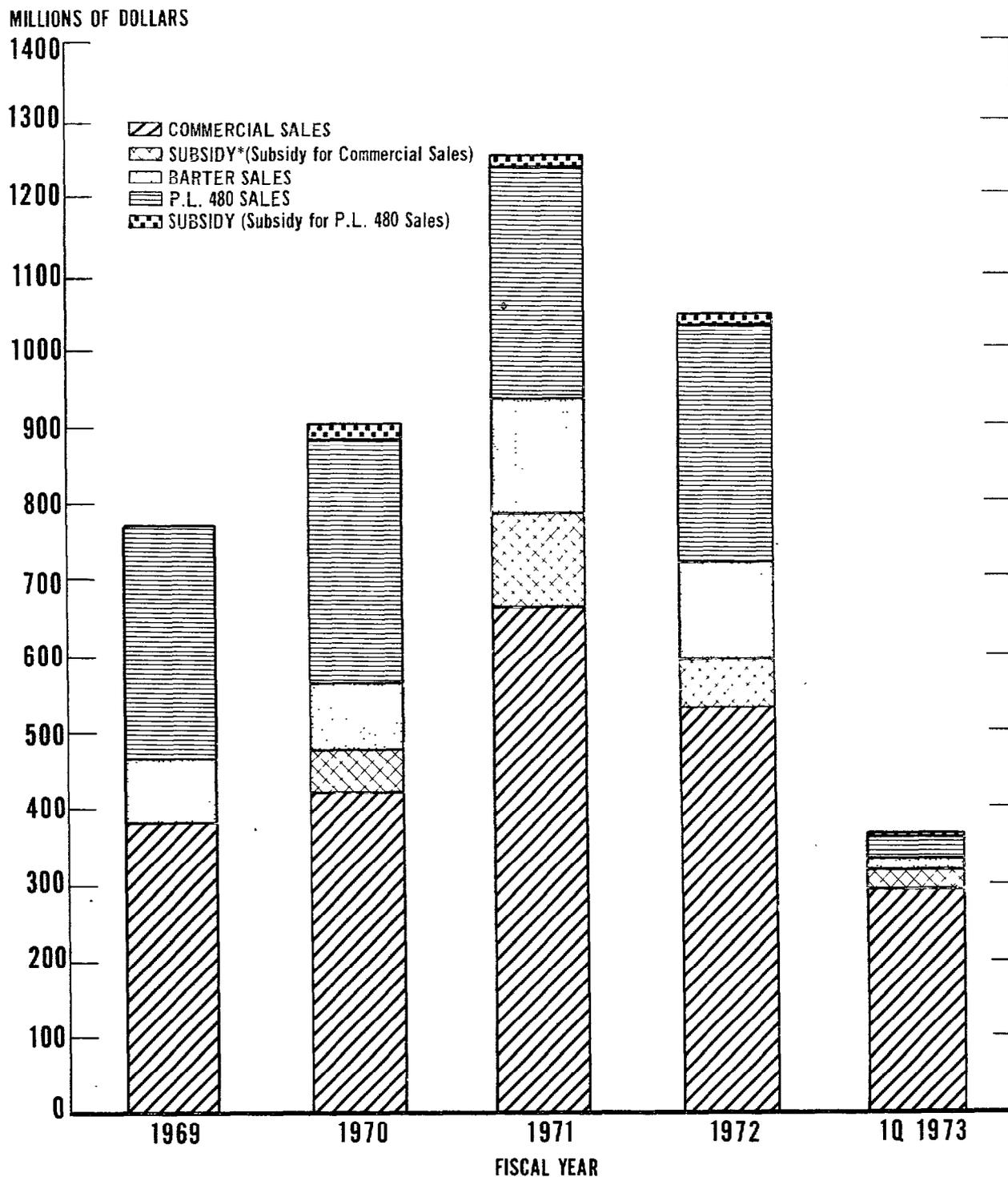
On March 8, 1973, the Comptroller General of the United States testified before the Senate Committee on Agriculture and Forestry on findings from our examination. In his testimony he stressed the need for management and program improvements. This testimony followed an interim staff report released early in our review in November 1972 because of intense congressional interest. Our final report reaffirms earlier observations on the need for management improvements because of the impact of such wheat sales on the domestic economy.

Six U.S. exporters were involved in the sales to Russia; five cooperated with us and made their records available for review. Our assessment of profits on these sales by the five exporters is continuing.

¹This is an approximate figure. Contracts include options to purchase. Some non-U.S. wheat may be shipped and other grains may be substituted for wheat.

²Hard Red Winter wheat, ordinary, f.o.b. gulf ports.

WHEAT EXPORTS AND SUBSIDY PAYMENTS—COMMERCIAL AND P.L. 480 SALES, FISCAL YEARS 1969 TO 1972 AND FIRST QUARTER 1973



*Payments have been reduced by proceeds of export marketing certificates
 SOURCE: Prepared by GAO from information provided by Department of Agriculture

The export subsidy payment procedure is as follows:

- Agriculture publishes daily the subsidy rates applicable through each market day for the various types of wheat.
- The exporter applies for subsidy, usually by a telephone call to Agriculture, and offers to export a certain quantity and type of wheat from a designated port.
- Agriculture accepts the exporter's offer, which fixes the subsidy rate the exporter is entitled to upon proof of shipment, and the exporter agrees to make the export or pay a penalty for nonshipment.
- Exporters submit proof of shipment to the Kansas City, Kansas, office of the Agricultural Stabilization and Conservation Service, which reviews and approves it for payment by CCC.

The program's primary objective is to keep U.S. wheat generally competitive in world markets. Regulations also state it is designed to:

- Avoid disrupting world market prices.
- Fulfill U.S. international obligations.
- Aid the price support program by strengthening the domestic market price to producers.
- Reduce the quantity of wheat which would otherwise be taken into CCC's stocks under its price support program.
- Promote the orderly liquidation of CCC stocks.

OTHER SUBSIDIES

In addition to the basic export subsidy, EMS provided a carrying-charge subsidy to cover the cost of owning wheat for future delivery. (See p. 37.) EMS also provided a rail subsidy for Hard Red Spring and Durum wheat to compensate exporters for the additional cost of shipping by rail when winter ice closed the St. Lawrence Seaway and upper Mississippi River.

CHAPTER 2

AGRICULTURE'S EXPORT TARGET PRICE POLICY

IN VIEW OF CHANGED WHEAT SITUATION

Early in the summer of 1972 Agriculture was concerned that wheat exports during the wheat marketing year beginning July 1, 1972, might not reach the previous year's levels. Smaller subsidy registrations dimmed the outlook for improving exports while a high yield and large wheat-carryover stocks made an increase in Government inventories likely. Concern over the need for increased wheat exports was well founded, but large sales of U.S. wheat to Russia and other exports later changed the picture drastically, causing an increase in the price of U.S. wheat. A chronology of events regarding the Russian sales is presented in appendix IV.

BACKGROUND OF WHEAT TRADING ACTIVITY

The President, in June 1971, rescinded an earlier directive requiring that at least 50 percent of any grain sold to Russia and certain other East European countries had to be carried on U.S. flag vessels. This action, together with a later announcement that maritime unions agreed to load grains bound for the Soviet Union on foreign flag vessels, made it economically and politically feasible for grain to be sold to Russia. Late in 1971 a substantial quantity of corn, barley, and oats was sold to Russia.

Further efforts to expand U.S. trading relationships with Russia resulted in the Secretary of Agriculture, the Assistant Secretary for International Affairs and Commodity Programs, representatives from the Department of State, and a team of grain specialists from Agriculture visiting Russia in April 1972. Discussions focused on the sale of U.S. grains and on credit arrangements to finance the purchases. These discussions culminated in an agreement on July 8, 1972, whereby the United States made available credit of \$750 million over a 3-year period for the purchase of U.S. grains, including wheat, corn, barley, sorghum, rye, and oats. Concurrent with and after negotiations on the credit agreement, members of the Russian state trading agency negotiated with private exporters to purchase about 440 million bushels of U.S. wheat--more than the total fiscal year

U.S. Export Subsidy Rates
and Related Export Prices for Hard Red Winter Wheat
for July 1 to September 25, 1972 (note a)

<u>Date</u>	<u>Delivered shipboard at U.S. port</u>	<u>Export subsidy rate (note b)</u>	<u>Net export price</u>
	(per bushel)		
July 3	\$1.68-1/4	\$0.05	\$1.63-1/4
5	1.69	.06	1.63
6	1.71-1/8	.07	1.64-1/8
7	1.69-7/8	.07	1.62-7/8
10	1.71-7/8	.09	1.62-7/8
11	1.76-1/4	.13	1.63-1/4
12	1.76-1/2	.13	1.63-1/2
13	1.76-1/2	.13	1.63-1/2
14	1.73-1/4	.10	1.63-1/4
17	1.74-1/4	.11	1.63-1/4
18	1.76-7/8	.13	1.63-7/8
19	1.79-1/4	.15	1.64-1/4
20	1.77-5/8	.14	1.63-5/8
21	1.76-1/4	.13	1.63-1/4
24	1.78-3/4	.14	1.64-3/4
25	1.79-1/8	.15	1.64-1/8
26	1.77-7/8	.14	1.63-7/8
27	1.76-5/8	.13	1.63-5/8
28	1.78	.14	1.64
31	1.79-3/4	.16	1.63-3/4
Aug. 1	1.80-1/2	.16	1.64-1/2
2	1.80-3/4	.17	1.63-3/4
3	1.88	.21	1.67
4	1.95	.31	1.64
7	2.05	.31	1.74
8	2.04	.31	1.73
9	1.96-1/4	.31	1.65-1/4
10	2.02	.36	1.66
11	2.04-3/4	.36	1.68-3/4
14	2.05	.36	1.69
15	2.02-3/4	.35	1.67-3/4
16	2.04	.36	1.68
17	2.08	.38	1.70
18	2.10-1/4	.38	1.72-1/4
21	2.10-1/2	.38	1.72-1/2
22	2.11-3/4	.38	1.73-3/4
23	2.14-1/4	.38	1.76-1/4
24	2.12	.38	1.74

QUESTIONABLE TARGET PRICE POLICY

Through its subsidy payments Agriculture attempted to maintain relatively stable price levels for U.S. wheat sold in overseas markets. From October 1971, Hard Red Winter wheat, the principal wheat exported by the United States, was priced at \$1.63 to \$1.65 per bushel and similar levels were established for other types of wheat in an attempt to retain the U.S. principal cash market in Western Europe and the market in Latin America.

The \$1.63 to \$1.65 range, referred to as the target price, was established October 1971 based on the price of competing Canadian wheat adjusted for quality and freight differentials. Although world market price levels were generally above the range, Agriculture retained the target prices as a matter of policy until about August 1972 despite earlier indications of a dominant U.S. position in available wheat supplies. Faced with rapidly increasing domestic prices, Agriculture could no longer maintain the target prices and reduced wheat export subsidies to zero in September 1972.

Basis for subsidy calculations

The basic ingredients considered in developing subsidy rates before October 1971 were the estimated U.S. port prices and prices offered for U.S. and competing wheats on world markets. Domestic buyers and sellers were contacted daily to develop a single price for wheat delivered to designated U.S. ports. World market prices were obtained from the Amsterdam-Rotterdam market for Europe and from the Japan Food Agency for Asia. Although world market prices continued to be collected, after October 1971 the data was no longer directly relevant because the subsidy was determined by comparing target prices with domestic prices at the port of export for each class of wheat.

The record did not show clearly the rationale and judgments exercised, the relative weights given the prices received, or the variety of other factors involved in establishing subsidy rates. A similar lack of documentation was observed in our report, "Review of Certain Aspects of the Wheat Export Program Conducted by the Commodity Credit Corporation" (B-160340, July 1967).

the United States having the only major stocks available and it would seem an excellent opportunity to feel out the international market place for somewhat higher prices."

In May 1972 the Secretary of Agriculture responded that the United States was not in a good position to raise export prices because exports were down due to recurring dock strikes and because of the necessity to protect its competitive position in world commercial markets. He pointed out that, while the Canadian Wheat Board had committed all of its exportable supplies for 1971 and 1972, some of the wheat was still in the hands of exporters and not actually sold to importing countries abroad.

However, the United States continued to dominate the world market into the summer months. The difficulty in obtaining other wheat was indicated in a cable from the Agricultural attache in the Netherlands in June that said European buyers had to search for Canadian wheat, for which they were willing to pay premiums over comparable U.S. wheat.

A Foreign Agricultural Service (FAS) study in April 1972, assessing the possible competition for supply of grains to Russia, revealed the world supply situation and commented that competing countries' stocks for exports were either low or committed or that the countries lacked the physical facilities for export movement.

"In the short-run, therefore, if the USSR were to enter the world market looking for a large tonnage of grains in addition to the wheat which it has already purchased from Canada, it would have to be content with relatively small quantities from several different suppliers, unless it were to buy from the United States."

Information on Russian crop conditions

The Agricultural attache in Moscow advised Agriculture officials in Washington, D.C., that the Soviet wheat crop would be adversely affected by freeze damage in a series of reports on February 18 (earlier by telegram), March 31, April 24, May 1, May 16, and June 26, 1972. The attache

Agriculture officials, therefore, were unsure how Russia's wheat problem might affect the United States, and analysts did not conclude that the information being reported had important trade implications for U.S. sales of wheat.

Agriculture officials also knew that Russian leaders had made a commitment to their people to increase the protein component of their diets by 25 percent in a 5-year period and that they needed increased foodstuffs and protein to meet this commitment. The Secretary of Agriculture testified before the Senate in March 1973 that, even in the absence of drought conditions in the Soviet Union, he thought they would have purchased at least half of their \$1 billion agricultural purchases from the United States because of this program.

Use of available commercial intelligence

Attache information on Russian crop conditions and other information relating to the dominance of U.S. wheat in the world market was available to EMS for setting daily subsidy rates.

EMS has no permanent statistical analysis group, but FAS and the Economic Research Service (ERS), with over 200 economists and analysts, are capable of providing timely and accurate information on complex foreign agricultural matters, including the world competitive situation.

FAS and ERS worked closely with EMS on policy matters and in planning export goals, but EMS based day-to-day subsidy rates mainly on information received from trade companies and on price quotations from the Netherlands and Japan. EMS did not fully use the FAS-ERS capability to assess the U.S. market position because of the previous policy decision to retain export target prices for U.S. wheats. Decisions on export price levels are made by the Assistant Secretary for International Affairs and Commodity Programs.

EMS officials discounted the U.S. position as the dominant supplier of wheat, contending that without low export prices the Russians and others may not have purchased the volume they did. It is, of course, impossible to know how buyers would have acted if wheat prices had been higher but failure to recognize the U.S. competitive advantage and

appeared to be based largely on Agriculture officials' intuitive judgment.

A principal reason for not increasing price levels was the fear that attractive levels would bring about increased world wheat production, with a resultant glut and future lower prices. This viewpoint has merit when world grain supplies are excessive and the long-term outlook is for production to exceed demand; it does not apply to a short-term situation where production shortfalls and other practical limitations (such as countries' logistical capacity and restrictions on the allocation of productive resources) dictate how much wheat will be produced for export. But again we found no indication that studies had been made of price levels that would give rise to greater production, the production that would result, and the effect on U.S. wheat exports. The Australian and Canadian Wheat Boards were concerned about Agriculture's continuing its price support policy. Referring to an Agriculture July 24, 1972, message reaffirming that prices could not be raised, the Australian Wheat Board on August 4, 1972, advised Agriculture of its disappointment:

"It is our positive and unequivocal view that because of the marked albeit somewhat unexpected change in the world demand and world supply situation there is no longer any justifiable or logical reason why prices should not be advanced. The demand from Russia, the short supply situation in Australia (our crop prospects are poor), the Canadian logistical situation, are only some of the factors which support this view. We are really disappointed to note the continued upward trend in U.S. subsidies which appears to us to indicate an intention to maintain net prices at about unchanged levels. Frankly we cannot envisage any more propitious circumstances than exist at present for an increase in world price levels."

The Canadian Wheat Board agreed, saying:

"We urge you therefore to reflect your market strength in your export prices rather than counteracting the market increases through additional subsidy."

IMPACT OF RUSSIAN SALES

A wide segment of the U.S. economy felt the effect of the compacted purchasing activity of Russian and other sales. On the positive side, the U.S. balance of payments benefited; U.S. exporters sold record amounts of wheat abroad; farm income increased substantially; surplus stocks were reduced; and idled acreage was put back into production.

On the negative side domestic wheat prices rose from about \$1.68 a bushel in July 1972 to \$3 in May 1973. Consumer costs attributed to the sales included higher prices for bread and flour-based products, increased prices for beef, pork, poultry, eggs, and dairy products resulting from higher costs for feedgrains, and a severe disruption of transportation facilities with attendant higher costs and shortages or delays in delivering certain supplies.

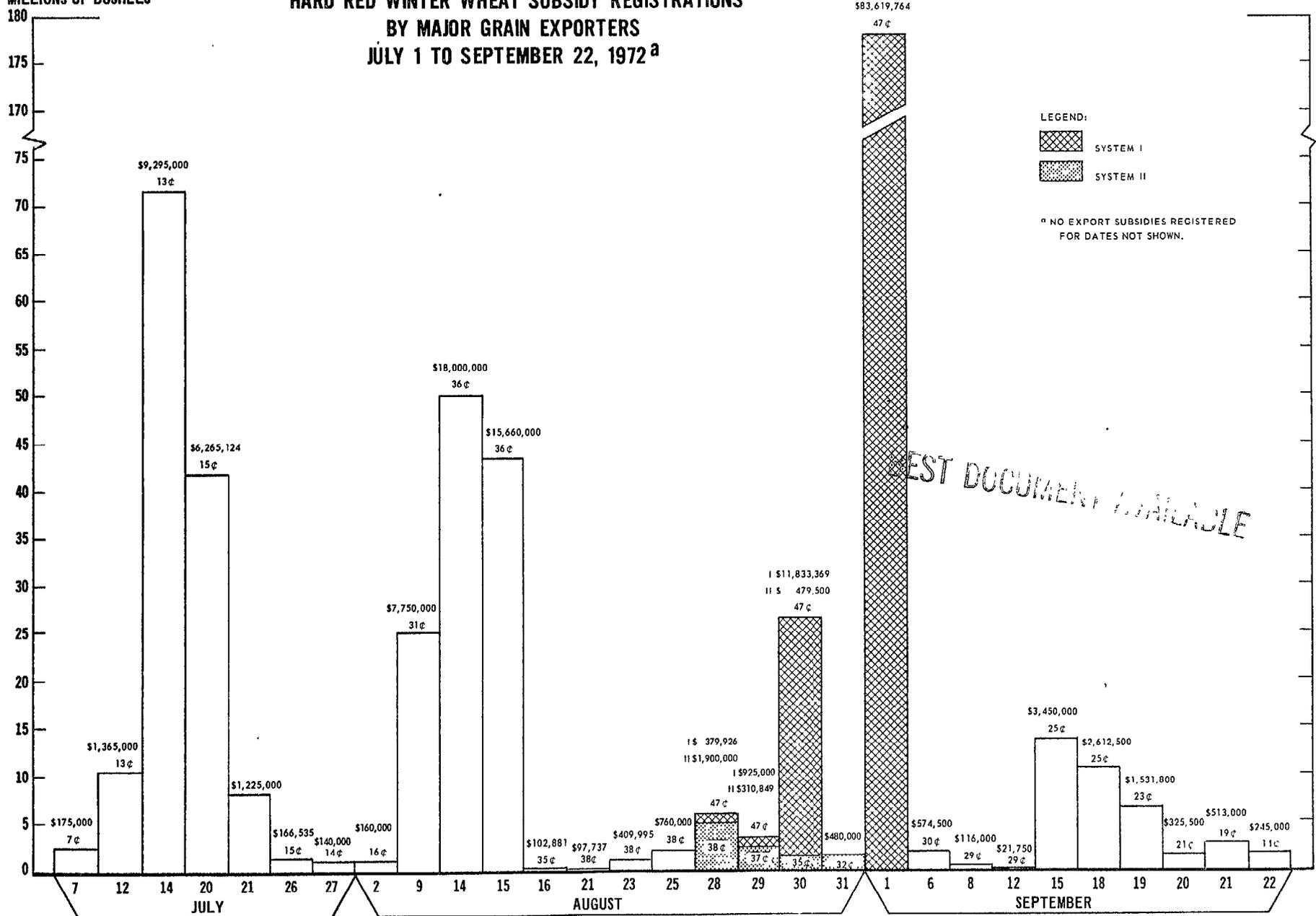
For registrations since August 1971 Agriculture required no information from the grain export trade on sales made, having discarded the reporting requirement because "it had no commercial intelligence value." The principal information it had relative to probable U.S. exports was registrations for export subsidy. Since exporters often delay registering sales or register without firm sales contracts, this information could hardly be considered timely or accurate. This lack of information on export sales consummated was a major impediment to managing the subsidy program because without it Agriculture could not fully assess the possible impact of these sales on the domestic price and availability of wheat and other feed grains, on subsidy obligations, and on the U.S. transportation system.

The Russians dealt with private exporters of U.S. grain and consummated purchase agreements totaling about 440 million bushels of wheat in July and August of 1972. Agriculture assured the major grain exporters of continued subsidy based on prevailing export target price levels. Exporters acting on this committed themselves for deliveries extending to June 1973 at fixed prices averaging about \$1.61 per bushel, which was below EMS target prices on the dates of sales.

Agriculture made a commitment to exporters to support the target price levels without knowing about the magnitude of Russian sales, and officials told us in September 1972 they were still unaware of the magnitude of sales made by the trade.

MILLIONS OF BUSHELS

HARD RED WINTER WHEAT SUBSIDY REGISTRATIONS BY MAJOR GRAIN EXPORTERS JULY 1 TO SEPTEMBER 22, 1972^a



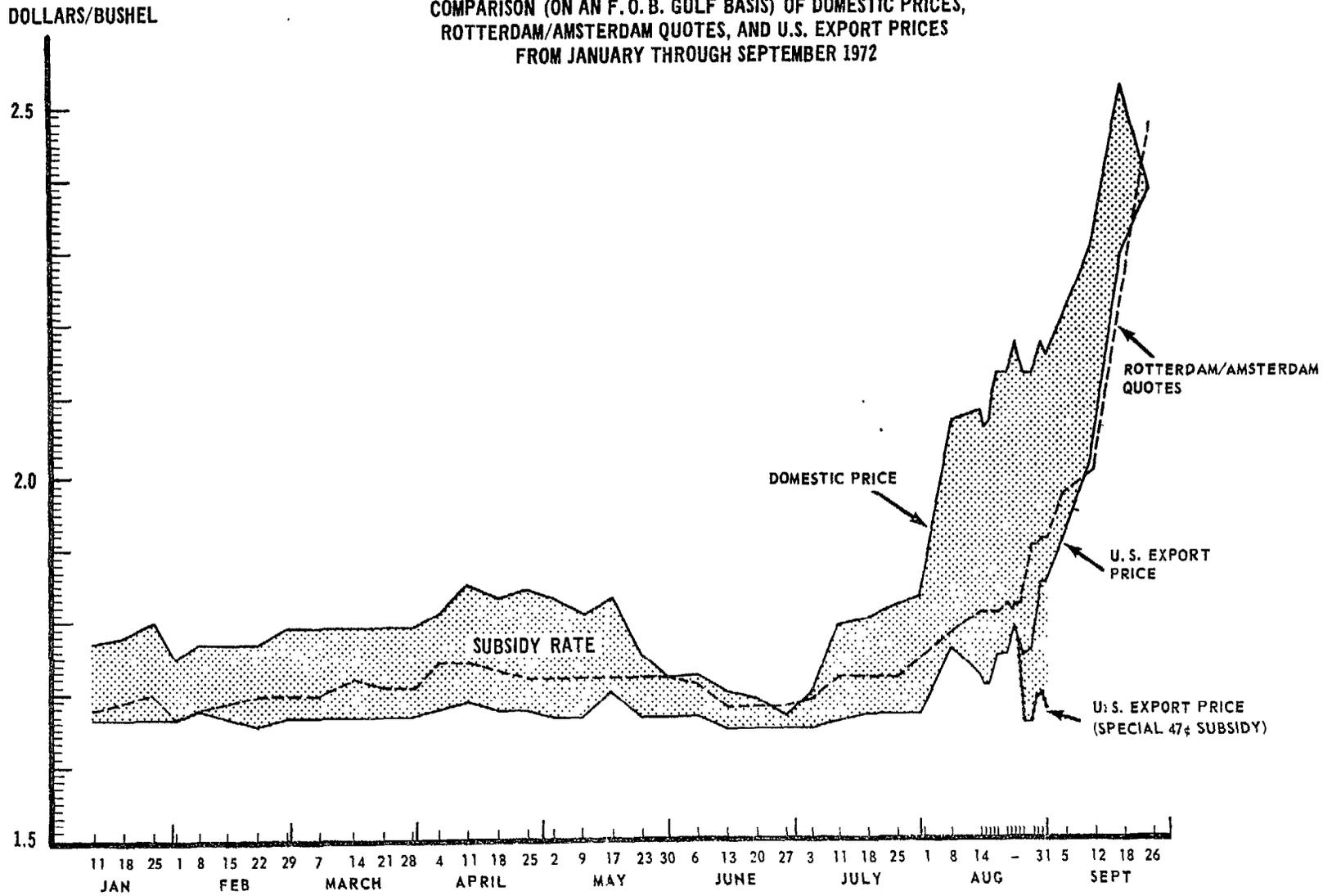
LEGEND:
 SYSTEM I
 SYSTEM II

^a NO EXPORT SUBSIDIES REGISTERED FOR DATES NOT SHOWN.

BEST DOCUMENT AVAILABLE

NUMBER 2 HARD RED WINTER WHEAT, 13.5% PROTEIN

COMPARISON (ON AN F. O. B. GULF BASIS) OF DOMESTIC PRICES,
ROTTERDAM/AMSTERDAM QUOTES, AND U.S. EXPORT PRICES
FROM JANUARY THROUGH SEPTEMBER 1972



CHAPTER 3

WEAKNESSES IN MANAGING

THE WHEAT EXPORT SUBSIDY PROGRAM

Agriculture's wheat export subsidy program provided an environment in which exporters gained or lost depending on when they bought and sold wheat and how well they gauged subsidy levels and when they registered their export sales. In a sense, it was an extension of their dealings in commodity futures since exporters took long or short subsidy positions which they traded among themselves. Subsidy was intended to equate the cost of purchasing wheat with export prices on the dates of sale, with a carrying-charge increment available to cover wheat held for future delivery. The registration system, however, allowed registrations at the exporter's option and gave exporters considerable maneuverability to take long positions (register without sales) on subsidy or to delay registrations when it was advantageous.

During periods of stable demand, and without fluctuations in price, the system may have worked well. But 1972 was an unusual year, and the compacted demands from July to September 1972 brought out the system's imperfections and highlighted the potentially adverse effect of exporters' speculating in subsidy registrations and maximizing carrying-charge increments. It should be noted that those practices were not improper in view of Agriculture's regulations which permitted them as a means of encouraging exports of U.S. wheat.

SPECULATING IN SUBSIDY REGISTRATIONS

Exporters sell their wheat at whatever price it brings in the marketplace. The export subsidy is based on EMS' published rates on the date CCC accepts the exporters' offer for export irrespective of the actual selling prices. Exporters collect the subsidy after shipments are made and documents are submitted. An October 1967 change in the program's regulations allowed exporters to apply shipments to any open subsidy registration. Also, exporters were permitted to register for subsidy at any time, whether a sale had been made or not.

Case	Bushels	1972 sale date	Subsidy at date of		Additional subsidy	
			Sale	Registration	Per bushel	Total
1	238,832	Aug. 16	\$0.24	\$0.44	\$0.20	\$ 47,766
2	275,575	Aug. 17	0.24	0.44	0.20	55,115
3	205,333	Aug. 5	0.27	0.53	0.26	53,386
4	257,203	Aug. 3	0.13	0.48	0.35	90,021
5	257,203	Aug. 3	0.25	0.53	0.28	72,017
Total						<u>\$318,305</u>

Additional cases of early and delayed registrations which resulted in additional subsidy entitlement of \$1.6 million are shown in appendix II.

EMS officials stated there was no evidence that the program has given rise to excess profit and that intense competition among exporters has served to police margins. These assertions, however, are unsupported by studies or audit. To test Agriculture's assertions and to examine the possible profitability under the subsidy registration procedures, we developed 50 additional cases. The basis for these selections and the results of our tests are detailed in appendix III. In these cases exporters registered for subsidy in advance of sales or delayed registering for several weeks after the sales dates. In each case these actions increased the subsidy payment to exporters, showing they were able to correctly gauge the subsidy's movement.

The 50 cases also showed that exporter sale prices were usually within a few cents of EMS export prices on the date of sales. However, the large subsidies available to exporters by delaying registrations made possible the likelihood of unusual margins.

We recasted the information and compared EMS calculations of the estimated costs of purchasing domestic wheat with exporter returns on the sales (sales price plus subsidy) to see if there was a possibility of unusual margins on this basis. As noted previously, it is not usually possible to relate specific wheat purchases and sales. The EMS price we used, therefore, is an approximation of the exporter cost of purchasing wheat to satisfy the sale; some wheat would have been bought before the sale, some after the sale. EMS advised us that the price was appropriate for export sales made for shipment 45 to 60 days ahead. There are obvious limitations to calculations which depend on

Trading in subsidies

A sample of 71 subsidy registrations during fiscal years 1972 and 1973 showed that 14, or about 20 percent, involved waivers of subsidy entitlement from one company to another. EMS officials told us that wheat frequently changed hands many times, as it is sold and resold at world market prices before export. In one case we understand wheat changed hands 26 times.

Companies bought at net prices (usually at about prevailing domestic prices minus subsidy) and exported the wheat purchased. Exporters waived their rights (to register these export sales and collect the subsidy) to the companies that sold the wheat. CCC's subsidy payment was made to the seller when the evidence of shipment was provided by the exporter. By using the exporters' waiver the seller satisfied his export contract with CCC and avoided the possible assessment of penalties for nonshipment.

We questioned these payments involving waivers on the basis that EMS regulations provided subsidy payments only for export shipments made by the registrants. EMS replied that its regulations permitted the practice and that although the subsidy recipient had not made the actual export it had caused an export to be made by selling the wheat and therefore was entitled to the payment.

Accepting the principle of obtaining subsidy payments for selling wheat domestically with the idea that eventually someone will export it introduces further speculation to the program. The waiver procedure undoubtedly facilitates transfers of wheat between companies. However, it distorts the existing contractual relationships and obscures the basic objective for which the subsidy was established because CCC ends up paying the registrant for shipments made by another company.

Waivers on sales made after termination of subsidy availability were questionable because exporters were no longer entitled to register for subsidy after that date and therefore had no rights to waive. Nevertheless, the mechanics of the registration system allowed subsidy registrants to satisfy their export obligation by this procedure.

Date	Sales contract data		EMS domestic price (note a)	Subsidy claimed (per bushel)			Total subsidy (note b)
	Bushels	Price		Export	Increment	Together	
Jan. 24, 1973	100,908.45	\$2.787	\$2.85	\$0.18	\$0.052	\$0.232	\$23,410.76
Oct. 13, 1972	255,145	2.50	2.51	.32	.021	.341	87,080.99
Oct. 12, 1972	321,724.63	2.47	2.51	.22	.008	.228	73,514.08
Oct. 19, 1972	268,713.18	2.62	2.59	.18	.059	.239	64,222.45
Feb. 20, 1973	192,202.67	2.62	2.64	.18	.067	.247	47,570.16

^aAt date of sale.

^bDifferences due to rounding incremental subsidy.

These examples lead us to conclude that the bulk of the \$36 million registered after September 2, 1972, may represent payments to exporters for wheat sold at world prices requiring no subsidy. In addition, by registering months before actually making sales, exporters will collect sizable carrying-charge increments. In short, Agriculture's failure to require evidence of a sales contract before registration gave exporters the opportunity for windfall profits.

MAXIMIZING CARRYING-CHARGE INCREMENTS

In addition to the basic subsidy, CCC paid exporters a carrying-charge increment to cover the estimated costs of owning wheat for delivery in a future period. Ownership of wheat is understood to cover insurance, interest, storage, and other costs which are passed on to the buyer. The carrying-charge increment was designed to enable U.S. exporters to compete with prices offered by the Canadian and Australian Wheat Boards, which bear the carrying charge for future delivery of wheat.

Payments are made to exporters of all classes of wheat exported on or after the 61st day following the registration for subsidy, with a maximum of 180 days. A payment rate policy of 1/20 cent a bushel a day for Hard Red Winter, Soft Winter, and White wheat and 1/30 cent a bushel a day for Hard Red Spring and Durum wheat was in effect from July 1971 until CCC suspended payment on all contracts it entered into with exporters after September 25, 1972. EMS estimated that as of March 7, 1973, about \$9.3 million had been paid for carrying-charge increments for registrations made from July 1, 1972. No estimate was made of the expected fiscal

EMS officials advised us that exporters passed on the combined basic subsidy and the carrying-charge increments to importers. However, in most cases we examined, combining these two subsidies caused higher payments to exporters than were available in the subsidy prevailing on the sales contract date. Exporters therefore, did not need the additional payment to pass competitive prices on to the buyers.

In the cases cited it is questionable whether the carrying-charge increment was crucial to making the sales. Permitting exporters to apply shipments to open registrations rather than computing the carrying-charge increment on the elapsed time between sales and deliveries is inappropriate because the registration dates are not related directly to the dates exporters enter into contracts or make shipments. Registrations, for the most part, represent attempts by exporters to estimate the subsidy rate at its high point. The sales contract date rather than the registration date should be the governing factor because it determines whether a forward sale is made. Had the entitlement been computed for the period beginning 61 days after the sales contract date in the above seven examples, no payments would have been made and about \$170,000 would have been saved. Total savings on the entire 28 cases noted would approximate \$350,000. Further savings would be involved in the registrations made in September 1972, which were being satisfied with contracts entered into many months later. (See pp. 36 and 37.)

- Sales made by U.S. affiliates to the parent international grain-trading firm in a foreign country, for resale to foreign buyers.

These definitions remained in effect until 1971, when program regulations were again revised and exporters were no longer required to submit notices of sales to Agriculture for subsidy payments. Changes in October 1967 relaxed administrative restrictions and provided a more flexible operating environment in an effort to maximize wheat exports under the program. Although that part of the regulations concerning affiliates was deleted, the Office of General Counsel interpreted Agriculture's position and cited several types of export transactions as not being bona fide sales under the program, including:

- When the affiliate purchased wheat from the U.S. exporter at the suggestion or under the instruction of the parent company.
- When wheat sold by a U.S. exporter to a foreign affiliate was supplied by the affiliate to a third party buyer under a sale concluded with the third party buyer by the U.S. exporter acting as agent for its affiliate.

Agriculture officials contended that the ability of some exporters to fix the export subsidy rate through their affiliate arrangements had enabled them to be more competitive in offering U.S. wheat to world markets. These officials were confident that affiliate arrangements had materially enabled the United States to maintain its fair share of commercial dollar markets.

The affiliate question reemerged in February 1971 as a result of Agriculture's requirement that Notices of Sale be filed promptly and be applied to the earliest open subsidy registration to be eligible for incremental payments. The revision which was drafted did not differ significantly from the Office of General Counsel's interpretation in 1967, and the 1971 revision was not incorporated into the regulations.

Agriculture did not issue the revision because of arguments from the trade. Most wheat exporters opposed the revision on the grounds that it would preclude competitive

However, many System I registrations were supported by contracts between such companies. For example, we noted contracts between U.S.-based companies of Japanese trading firms and their related companies in Japan and between two U.S. companies, Cargill, Portland and Cargill Americas, Coral Gables, Florida. Still other contracts were between domestic and foreign affiliates--Continental, New York and Continental, Paris; Bunge, New York and Bunge, Rotterdam.

In recent years Agriculture has sacrificed management control, believing that a more flexible approach to affiliate relationships would produce increased wheat exports. On several occasions definitive regulations were drafted but none were accepted. Agriculture has consistently taken the position that tighter regulations concerning affiliate relationships would cause reduced wheat exports and would contradict program objectives.

Failure to define and clarify affiliate relationships has created an environment for possible misuse and abuse of the subsidy program. The lax regulations concerning affiliates could give some exporters an advantage in speculating on the subsidy by establishing preferential pricing relationships. Since Agriculture looks to such prices to establish subsidy levels, such relationships could cause unnecessarily high subsidies.

EMS states that there is no known method for accurately determining or enforcing regulations that require affiliates to act independently in wheat export transactions. However, recent disallowance of subsidy registrations of one company acting as an agent for another company indicates that more can be done.

Although the Office of Inspector General has made numerous compliance reviews of program regulations in the past, we are not aware of any directed to determining whether parties to export transactions acted independently. We called one possible case to the attention of EMS who advised us they would look into the matter. At the completion of our fieldwork, EMS had not made further substantive inquiries. Without such reviews, a reasonable doubt exists of the legality of past affiliate export transactions. Agriculture should review past transactions to insure they have been consistent with program regulations.

Stabilization and Conservation Service offices around the country, the Kansas City futures market, and other contacts. EMS contacts similar sources in computing its domestic wheat price but considers other factors as well and usually ends up with a different domestic price than that accepted by CCC.

Implications of having two domestic wheat prices are that:

- If the CCC price is understated, the buyer has a possible built-in profit on the price differential. A 4-cent profit on a 60 million bushel transaction amounts to \$2.4 million and on 7 million bushels to \$280 thousand.
- If the buyer exports the CCC wheat, he collects an equivalent amount in subsidy because the subsidy is based on EMS' higher domestic price.

The Stabilization and Conservation Service and EMS consider each other as information sources but do not coordinate their establishment of domestic prices. The large amounts involved suggest the need for more effective program coordination. This could be a procedure whereby, on export transactions involving wheat purchased from CCC inventory, subsidy would be paid on the difference between the world market price and the lesser of (1) the purchase price paid for CCC wheat or (2) EMS' computation of the domestic price of wheat. Such a procedure would eliminate possible undue profits being made on the subsidy on wheat purchased from CCC.

restrictions on travel, etc. The attache in Moscow, for example, is impeded because agricultural information is classified as "state secrets" and he cannot travel freely to examine crop conditions. Attaches in general, however, are able to provide a constant flow of information to Agriculture.

Attache reports, trip reports, traveler debriefings, international trade conferences, foreign publications, and official foreign wheat board reports are the principal sources of information. FAS and ERS analysts use the information to report current situations and short-range forecasting, to alert management to new market potentials, and to provide decisionmaking information to the agricultural community.

Disseminating foreign agricultural information on major U.S. competitors is an important task of the analyst. Communications from overseas posts contain current data and are brought to the attention of appropriate Agriculture officials. Significant current developments are reported internally through short, one- or two-line news statements. If an item is exceptionally newsworthy, analysts prepare in-depth highlight statements. The most significant news items reach top management, usually in the weekly "Secretary's Highlight."

The chart on page 48 presents a composite view of the commercial intelligence system.

DISSEMINATION TO FARMERS

The Agricultural Act of 1954 directs Agriculture to acquire foreign information to assist "American farmers, processors, distributors and exporters to adjust their operations and practices to meet world conditions * * *." A basic objective of the act is to insure the systematic flow of significant agricultural economic and trade data from foreign posts to the U.S. public.

We focused on how Agriculture disseminated information to American farmers because of the concern regarding the information flow. Agriculture generally disseminates information considered reliable and supportable through publications and press releases to the news media. This information is available in Agriculture publications and is obtained by

being placed on distribution lists. Recipients include numerous colleges, newspapers, businesses, and agricultural groups, but few farmers. Virtually all unclassified information received by Agriculture is indexed, listed, and available to the public upon request.

Some important publications containing foreign agricultural information and available to the public are:

1. Foreign Agriculture Magazine
2. World Agricultural Production and Trade
3. Foreign Agricultural Trade of the U.S.
4. World Agricultural Situation
5. Regional Agricultural Situation Reports
6. Indices of Agricultural Production
7. Situation Reports
8. Unscheduled circulars and long-range studies

These periodic publications are available to any subscriber. The weekly, monthly, and unscheduled reports communicate recent and significant developments in foreign agriculture. At the end of the year, the combined effects of the year's activities are analyzed and reported.

Agriculture also informs the farm community of foreign agricultural developments through its Extension Services--a three-way partnership, with State land-grant universities and county governments sharing in the planning and financing. State extension specialists help farmers and processors to assess the economic effects of foreign markets and consumer preferences.

The Washington, D.C., Extension Service staff is small and depends on the field offices to carry out most of the operational programs, but State specialists responsible for disseminating foreign agricultural data to the farmers have many other duties. Most county agents who deal with the farmer on a more personal, one-to-one relationship are expert only in domestic agricultural matters, and these issues take much of their time. Extension officials estimate that about 70 percent of U.S. farmers are not properly informed on foreign agriculture and that those who are informed are usually industry leaders.

outlook for 1972/73 was brightened by the recently announced 3 year, \$750 million grain agreement with the USSR. * * * With demand continuing firm, wheat prices received by farmers this season may average around the \$1.31 per bushel of 1971/72."

Farmers generally do not receive foreign marketing data directly from Agriculture and tend to base marketing decisions on the advice of national and local farm publications. Agriculture officials stated farmers are not interested in and do not benefit directly from its published information. Nevertheless, the farmers' reliance on secondary information sources for marketing decisions makes it important that Agriculture provide accurate, complete, and timely information with appropriate interpretive comments. This need is illustrated by statements of representatives of three publications that they used Agriculture's statistics when preparing articles interpreting market conditions for their readers. Two of these publications having a total circulation of over 2 million farmers advised readers to sell their wheat early in 1972 because prices would drop due to the large harvest and limited export market.

These representatives stated that most farmers followed the advice to sell and sold in historic selling patterns. Some even sold before their normal time because of the projected market conditions. The following table shows that farmers in certain States received less for 1972 wheat crops than for 1971 crops.

	<u>May</u>		<u>June</u>		<u>July</u>	
	<u>1971</u>	<u>1972</u>	<u>1971</u>	<u>1972</u>	<u>1971</u>	<u>1972</u>
	—————(dollars per bushel)—————					
Texas	\$1.43	\$1.43	\$1.50	\$1.35	\$1.46	\$1.38
Oklahoma	1.44	1.45	1.47	1.35	1.39	1.40
Kansas	(a)	(a)	1.39	1.27	1.29	1.31
Illinois	(a)	(a)	1.47	1.30	1.40	1.35
Missouri	(a)	(a)	1.44	1.31	1.39	1.35

^aOld season. Monthly data indicates new crop season. Wheat Situation Report, ERS (Aug. 1972).

CHAPTER 5

PROGRAM EVALUATION NEEDS

Several reviews of selected aspects of the wheat export subsidy program have been made. But, despite annual outlays of millions of subsidy dollars, Agriculture has not comprehensively evaluated the program to assess whether objectives were being achieved efficiently and economically. An excerpt from a congressional study on Federal subsidy programs in 1958 appropriately stated:

"Federal programs aimed at supporting or improving the economic position of particular groups or industries should be constantly reevaluated in the light of changing circumstances. Whatever the initial justification, subsidy programs should be so contrived as to eliminate the necessity for their continuation. The broad changes which must be expected in our economy require frequent revision in the scope and character of these programs if they are to achieve their purposes. Failure to adapt the substance of subsidies to changing demands and opportunities may be expected to prevent most efficient use of resources in the subsidized activities as well as in other types of economic endeavor. Where this is the case, the subsidy not only fails of its immediate objective but also imposes real costs on the entire economy over the long run."

IMPORTANCE OF PROGRAM EVALUATION

The Comptroller General of the United States advocated the importance of program evaluation as a fundamental part of effective program administration in an August 11, 1972, letter to 34 congressional committee chairmen and the Director, Office of Management and Budget:

"* * * The responsibility (for program evaluation) * * * should rest initially upon the responsible agencies. * * * I have requested our [GAO] staff, in the conduct of audits, to give particular attention to this problem and to include in our advice to the Congress our appraisal as to how well

It examines the extent to which program activities have been carried out in relation to the opportunities that have the most favorable benefit/cost ratios or otherwise maximize the beneficial effects in relation to cost."

PROGRAM EVALUATION EFFORTS

EMS officials believe export subsidies are necessary to insure the United States a competitive position in the international wheat market. They advised us that the program is constantly evaluated to maximize export of wheat on commercial terms with a minimum payment of public funds and contended that the program's effectiveness was self-evident in the increased volume of exports over the past few years. While some consideration is given supply and demand variables in conjunction with determining subsidy levels, such analyses clearly do not conform to the Office of Planning and Evaluation's definition of program evaluations.

Major program changes in 1967 and 1971 were not precipitated by formal comprehensive evaluations. Instead, these important changes were made as a result of a series of informal meetings between some members of the trade and Agriculture officials.

Although a comprehensive evaluation of the conceptual need for subsidy or of the effectiveness of the operative program has never been made, analyses of selected aspects were completed by the Office of Planning and Evaluation in 1970 and 1972. A report in November 1970 on Public Law 480 Supply Management questioned the effectiveness of the use of subsidy:

"* * * Available data suggests that in fiscal year 1970 from 1/2 to 2/3's of the effectiveness of most export payments was neutralized by increases in U.S. domestic prices. This adds to costs without contributing to exports * * *."

A paper on a market-oriented export payments policy for wheat in October 1972 suggested that

"* * * when the U.S. supply situation is scarce or when there is a surge in demand, the upward

whether Agriculture's confidence in the effectiveness of the wheat export subsidy program was merited, we examined several pertinent statistical relationships for the 12 years immediately preceding the 1972 Russian wheat sales.

Using a simplistic model based upon correlation and regression analysis, we found that

- the average monthly prices of U.S. #2 Hard Red Winter wheat and the two major competing varieties of Australian and Canadian wheat in three international markets were highly correlated;
- the total variation in prices of all three major export varieties of wheat on these markets explained only 58 percent of the variation in Agriculture's net export prices;¹ and
- the differences between the trading prices of the three competitive varieties of wheat in the three markets and Agriculture's corresponding net export price explained only 40 percent of the variation in U.S. wheat exports.

This data suggested that EMS' established prices did not accurately reflect prevailing international prices for the period before the Soviet wheat transactions. Export prices on this basis act as a mechanism for maintaining or enlarging the U.S. share of the international wheat market. But, based on the stated program objective of making U.S. wheat competitive in international markets, Agriculture seems to have paid greater subsidies than this market required.

We did not seek to develop a position on the conceptual need for a subsidy program but considered the views of some knowledgeable persons and examined some statistical relationships. There is sufficient evidence, in our opinion, to suggest that reinstatement of the program needs to be predicated on a meaningful justification for its existence.

¹Our measure of the net export price for the 12 years of data represented in 144 monthly observations of our survey was the average monthly delivered gulf port price less the net export subsidy. The result is slightly higher than the actual net export prices.

CHAPTER 6

CONCLUSIONS, AGENCY COMMENTS, AND

OUR EVALUATION AND RECOMMENDATIONS

As a consequence of the export sales to Russia and to other buyers, considerations emerged which transcended the magnitude of the subsidies involved, including the United States' need to

- establish rules and procedures for transactions involving unusual purchases of critical commodities;
- assess beforehand the possible impact of these exports on broad segments of the economy;
- establish more sophisticated and comprehensive information systems using its abundant resources for collection and analysis, responsive to rapid changes in world conditions; and
- more strongly emphasize evaluation of the effectiveness of major programs to ascertain that objectives are being achieved efficiently and economically.

CONCLUSIONS

The information available to Agriculture early in 1972 showed that the United States was the dominant supplier of major wheat quantities. Assessment by FAS of the U.S. position and reports by attaches in the Netherlands, Canada, and Australia tended to confirm this. Information on Russian crop conditions--although imprecise in terms of possible quantities--the imminent signing of a credit agreement with Russia for the purchase of grains, and Russia's program to increase the protein content of its peoples' diets was adequate to at least alert Agriculture to the possibility of large purchases by the Russians. The world wheat demand situation, including that posed by Russia, put Agriculture in a position to allow world prices to rise, thereby reducing subsidy levels and increasing balance-of-payments benefits. Nevertheless, despite what seemed to be clear signs of a strong position in world wheat, Agriculture perpetuated a policy of target prices from October 1971 to late August 1972, before finally terminating the program in September.

conditions was not equipped to cope with sizable Russian wheat purchases with private exporters outside Agriculture's purview. Entrance of the purchasing agency into a relatively stable market with huge, unanticipated orders altered the entire supply-demand balance, driving wheat prices sharply higher. Intelligence on these orders was not accumulated timely and available information was not used effectively in establishing daily subsidy rates. Agriculture's hands-off attitude indicated these were normal commercial transactions; but they were not normal commercial transactions because of the large quantities and heavy subsidies involved and the effect the purchases had on various segments of the U.S. economy.

Clearly, different ground rules should apply in similar-sized transactions, particularly those involving state trading monopolies. We believe Agriculture relied too much on the competitiveness of the wheat export trade to police its program. By doing so Agriculture was inattentive to fundamental safeguards on the effectiveness of administrative procedures governing the program. Some of the basic tests we made on registration practices would have served well to periodically evaluate these procedures. We believe Agriculture should have developed a monitoring system for continuous evaluation of the effectiveness of its registration system.

Information for setting daily subsidy rates was not used effectively, nor were ERS and FAS support groups who were capable of assessing the world wheat situation. A more sophisticated management approach, appropriately weighing pertinent world supply-demand factors and setting daily subsidy levels instead of a rigid pricing policy probably would have reduced or eliminated subsidy levels much sooner.

When Agriculture did deviate from its pricing policy, it gave exporters who had relied on its representations and entered into sales contracts at low prices a special rate for 1 week and the opportunity to equate their purchase and sales prices. Agriculture did not have knowledge of exporters' positions, their need to purchase wheat, or prices needed to satisfy their obligations, and its actions could have been unfair to exporters who were in short positions

It is clear that the bargaining power of the Russian state trading monopoly over the several partially informed sellers allowed it to buy wheat at bargain prices. We estimate that about half the \$300 million in subsidy payments will go toward compensating exporters who had to cover their Russian sales with high domestic purchase prices.

We believe that the subsidy registration system provided the opportunity for unusual profit margins in other sales subsidized during fiscal years 1972 and 1973. Our examination was not comprehensive enough to comment on the full dimensions of these margins. In summary, however, we believe the U.S. Government incurred greater program costs than necessary.

AGENCY COMMENTS AND OUR EVALUATION

The Secretary of Agriculture advised that our study will prove useful in helping the Department make program improvements for the future. The Secretary agreed with our major recommendation that a thorough review of the program be made to assure that its reinstatement is necessary. He also agreed that (1) maximum information about purchasing intentions of nonmarket economies was needed, (2) gathering commercial intelligence for farmers and traders should be strengthened, and (3) commercial sales, concessional sales, and sales from CCC inventory should be better coordinated into a cohesive wheat export policy.

The Secretary, however, disagreed with us on some other observations and conclusions. These are presented with GAO's evaluation as appendix I.

The Secretary also provided us with detailed comments on certain matters in the report, but because of the lateness in receiving them, we were unable to fully assess each comment. Our preliminary assessment was that agency comments would not change our conclusions and recommendations; however, we plan to review them in more detail at a later date, and if appropriate issue a supplement to this report.

RECOMMENDATIONS

We recommend that the Secretary of Agriculture take the following actions on the issues below.

- Document the basis and reasoning used in establishing daily subsidies.
- Direct that sales and cost data on wheat transactions be used in establishing and checking the reasonableness of subsidy levels, and consider flexible subsidies according to geographic locations and circumstances.
- Better coordinate commercial sales, concessionary credit sales, and sales from CCC inventory into a cohesive wheat export policy having appropriate safeguards on subsidy payment amounts.
- Consider revising the basis for computing entitlement to the carrying-charge increment.

audits can be conducted under procedures which will assure that section 12 will not be violated.

We reported to the Congress in our "Review of Certain Aspects of the Wheat Export Program Conducted by the Commodity Credit Corporation" (B-160340, July 1967).



DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

June 11, 1973

Mr. Elmer B. Staats
Comptroller General of
the United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Staats:

This is in reply to Mr. Stovall's memorandum of May 16, 1973, transmitting a draft report on the Russian wheat sales and Agriculture's management of the Wheat Export Subsidy Program and soliciting our comments.

The Export Marketing Service of the Department commented in detail on an earlier draft, and we are pleased to note that numerous changes have been made on the basis of these comments. We are again commenting in detail on the revised draft, and these comments are enclosed. My letter will be confined to some of the more general aspects of the report.

First, let me say that we greatly appreciate the time and effort that GAO has put into this study. It will no doubt prove useful to have had the study made during the period when the program is suspended and it should be helpful in making improvements for the future.

The Department agrees that if we are to have increased trade with the Communist countries, it will be desirable for our Government to have the maximum information it can obtain about the purchasing intentions of these non-market economies. To the extent that this can be done without jeopardizing export business, we intend to do it.

To strengthen further our gathering of commercial intelligence for farmers and traders, we have developed a system for voluntary reporting of export sales of U.S. grains by trading companies, with the first report scheduled for issuance to the public in July. This will cover all export sales of grains and soybeans by reporting companies. That is as far as we believe we can go without unduly interfering with the competitive rights of the trade.

We agree with the recommendation that a thorough review of the program be made before its reinstatement to assure that its resumption is necessary. The Department has always opposed export payments on principle and has used them as sparingly as possible and only in cases where necessary to meet export competition. Such programs exist only to

GAO note: Numbers in brackets refer to our numbered comments on pp. 73 to 76.

the U.S. harvest and sale of wheat by producers had begun. [3]

We would have no serious objection to the formation of a joint Government-business committee to study the information needs of various interested groups and devise methods of meeting them. However, we question that such a study would add significantly to the information developed by similar groups in the past, most recently the information advisory committee whose report led to establishment in 1973 of a new Office of Communication responsible directly to the Secretary. The press serving farmers and the grain industry is aggressively seeking information every day that its constituent groups want, and the Department is well geared to supply it. [4]

We have no evidence that would confirm the GAO statement that the program has given rise to windfall profits by grain companies. Competition between exporters is intense, and this has served well to police margins. The fact that some sales prices plus subsidy may have been above USDA's computed export price on a particular day does not mean the exporter received an excessive profit--or any profit at all. Domestic wheat prices were rising sharply in this period. Obviously, exporters had to pay higher prices for U.S. wheat than they had intended when they made the fixed price sale. [5]

We do not agree that the type of wheat export payment program we were using was not equipped to cope with a large volume of purchases, such as those made by the Soviet Union. On the contrary, the Soviet sales could not have been made under the pre-1967 system which required that a sale already be made before subsidy was applied for. When large export sales are made, it is impossible for the exporter to buy sufficient cash wheat or to hedge his sale in the futures market during the 24-hour life of the subsidy for which he registers. The exporter would have been unable to protect himself from a certain increase in the domestic price, and it is highly unlikely that the sales would have been made at all. [6]

The correlation and regression analysis used by your staff is too greatly oversimplified to yield meaningful results regarding the effectiveness of a wheat export payment program. It assumes that high export payments must occur in the same months or years as high exports for the payments to be proven effective. This ignores such essential factors as total world wheat trade, total stocks of exporting countries, and total U.S. stocks that must be taken into consideration in evaluating the effectiveness of the export subsidy. [7]

We feel that flexible subsidies that vary according to geographical locations are theoretically appropriate but not practicable or reasonable. They can be a source of irritation to our customers and thus be counter-productive. [8]

GAO COMMENTS ON
THE SECRETARY OF AGRICULTURE'S LETTER OF
JUNE 12, 1973

1. We agree that it is uncertain whether the volume of wheat exports to Russia and other nations would have occurred at higher prices. However, we believe that Agriculture's management system should have been more responsive to changes in the world demand-supply situation. Had prices been allowed to rise and even though the volume of wheat exports had been reduced, the proceeds from the lower volume at higher prices could still have yielded greater net benefits to the United States.

Whether the Department's policy yielded the best results is a matter of judgment which cannot be precisely determined. However, we believe the internal studies and commercial intelligence available to Agriculture at that time indicated that it should have revised the program and terminated subsidies much sooner than it did.

2. It is not our intention to emphasize the urgings of Canadian and Australian officials to increase the level of world wheat prices. The information was presented in the context that these countries and trade sources believed that the time was appropriate for a rise in price levels because of the world supply-demand situation.

Although possible, it is not a natural consequence that increased prices would result in increased production. Therefore we expected that a detailed evaluation would have been made of the reasons such an event was considered likely. This had not been done.

Both Canada and Australia reportedly made sales during the summer of 1972. However, most of Australia's sales were long-term commitments. Other Australian and Canadian sales were relatively minor compared to the immediate demand on U.S. stocks posed by the sales to Russia.

3. We did not intend to convey the impression that Agriculture knew about Soviet buying intentions and

We recognize that exporters had to buy U.S. wheat in a sharply rising market. Our test of possible profits is based on the EMS price of domestic wheat at the date of sale. Because Agriculture lacked more precise information, this seems a reasonable basis. To the extent that exporters bought their wheat in a rising market to cover sales at lower prices, profits would be adversely affected. Our test demonstrates the possibility of unusual margins because of the registration system which makes the U.S. Government an involuntary participant in gaining or losing on market fluctuations.

The possibility of unusual margins inherent in the registration system dictates that Agriculture find a way to remove the U.S. Government from speculative transactions and make periodic checks into the reasonableness of the established rates.

6. The then-existing program did not require information from the trade at the time of sale. Agriculture therefore had no way of assessing the implications of such large sales on the domestic economy. In this respect Agriculture was an involuntary participant to the disruptive effects of Russia's large purchases made in a short time-frame.

Whether the Russian sales would have been made without allowing exporters to fix subsidies at later dates is speculative on Agriculture's part since there is no way to know. However, it is clear that exporters could not have risked selling large quantities without being covered by stocks on hand or under contract or by subsidy registration against expected increases in the domestic price of wheat. Therefore, when Agriculture assured exporters that the subsidy program features would continue unchanged, this tended to minimize the risk to exporters in contracting for large quantities of wheat at fixed prices.

Had exporters been required to register their sales when made, two things would have likely happened. First, exporters would have priced their wheat on the basis of only those quantities they could deliver at that price, and the contracts would have provided for the expected rise in domestic wheat prices. In this way the Government's subsidy payment costs would have been minimized and

BEST DOCUMENT AVAILABLE

APPENDIX II

EXAMPLES OF EARLY AND DELAYED REGISTRATIONS

Case	Bushels	Type of wheat	Sale date	Regis- tration date	Subsidy at date of		Additional subsidy	
					Sale	Regis- tration	Per bushel	Total
EARLY REGISTRATIONS:								
1	29,865	DNS ^a	2-29-72	9-30-71	\$0.06	\$0.11	\$0.05	\$ 1,493.25
2	19,756.12	DNS	12- 9-71	10-13-71	.06	.19	.13	2,568.29
3	23,567	DNS	12- 9-71	10-13-71	.06	.19	.13	3,063.71
DELAYED REGISTRATIONS:								
4	54,112.33	DNS	7-28-72	8-30-72	.21	.53	.32	17,315.94
5	20,519.65	DNS	7-28-72	8-30-72	.21	.53	.32	6,566.29
6	9,093.98	DNS	7- 6-72	8-30-72	.16	.53	.37	3,364.77
7	109,127.70	DNS	4-27-72	8-30-72	.23	.53	.30	32,738.31
8	55,340.40	DNS	3- 3-72	8-30-72	.25	.53	.28	15,495.31
9	115,162.80	DNS	12- 7-71	8-30-72	.19	.53	.34	39,155.35
10	477,604.94	HRW ^b	8- 4-72	8-29-72	.10	.44	.34	162,385.68
11	98,710.97	HRW	8-14-72	8-29-72	.23	.51	.28	27,639.07
12	48,861.35	HRW	8- 4-72	8-29-72	.10	.44	.34	16,612.86
13	201,609.87	HRW	7-19-72	8-29-72	.13	.47	.34	68,547.35
14	457,333.33	HRW	7-25-72	8-29-72	.14	.47	.33	150,920.00
15	115,748.03	HRW	7-25-72	8-29-72	.14	.47	.33	38,196.85
16	173,622.05	HRW	7-25-72	8-29-72	.14	.47	.33	57,295.28
17	160,000	HRW	7-17-72	8-29-72	.10	.47	.37	59,200.00
18	470,000	HRW	7-19-72	8-29-72	.13	.47	.34	159,800.00
19	5,000	WW ^c	8-21-72	9- 1-72	.20	.43	.23	1,150.00
20	460,784.30	WW	8-21-72	9- 1-72	.20	.43	.23	150,980.39
21	14,215.70	WW	8-21-72	9- 1-72	.20	.43	.23	3,269.61
22	55,440	DNS	8-10-72	9- 1-72	.23	.37	.14	7,761.60
23	18,480	DNS	8-15-72	9- 1-72	.28	.37	.09	1,663.20
24	54,605.60	DNS	5-24-72	9- 1-72	.01	.37	.36	19,658.02
25	51,639.35	DNS	7- 3-72	9- 1-72	-	.37	.37	19,106.56
26	18,480	DNS	8-22-72	9- 1-72	.30	.37	.07	1,293.60
27	234,024	DNS	8- 9-72	9- 1-72	.23	.37	.14	32,763.36
28	32,808	DNS	8-14-72	9- 1-72	.32	.53	.21	6,889.68
29	17,150.78	DNS	8-22-72	9- 1-72	.40	.53	.13	2,229.60
30	192,192	DNS	8-22-72	9- 1-72	.40	.53	.13	24,984.96
31	279,681.07	DNS	8-22-72	9- 1-72	.40	.53	.13	36,358.54
32	110,880	DNS	7- 3-72	9- 1-72	-	.37	.37	41,025.60
33	18,188.97	DNS	6-27-72	9- 1-72	-	.37	.37	6,729.92
34	45,235.58	DNS	5-24-72	9- 1-72	.01	.37	.36	16,284.81
35	37,146.67	DNS	5-25-72	9- 1-72	.01	.37	.36	13,372.80
36	66,864.00	DNS	6- 2-72	9- 1-72	-	.37	.37	24,739.68
37	95,989.34	DNS	7- 3-72	9- 1-72	-	.37	.37	35,516.05
38	38,104.66	DNS	7- 3-72	9- 1-72	-	.37	.37	14,098.72
39	10,255.98	DNS	5-24-72	9- 1-72	.01	.37	.36	3,692.15
40	201,520.66	DNS	8- 5-72	8-28-72	.27	.53	.26	52,395.37
41	141,600	HRW	7-19-72	8-31-72	.09	.48	.39	55,224.00
42	242,983.97	HRW	7-19-72	8-31-72	.09	.48	.39	94,763.75
43	204,174.63	HRW	7-19-72	8-31-72	.09	.48	.39	79,628.10
44	47,679.77	HRW	7-26-72	8-31-72	.10	.48	.38	18,118.31
45	14,392.38	WW	8-21-72	9- 1-72	.20	.43	.23	3,310.25
46	183,012.66	WW	8-21-72	9- 1-72	.20	.43	.23	42,092.91
47	32,666.04	WW	8-21-72	9- 1-72	.20	.43	.23	7,513.19
48	68,666.66	WW	8-21-72	9- 1-72	.20	.43	.23	15,793.33
49	55,115	HRW	8-21-72	9- 1-72	.38	.47	.09	4,960.35
50	15,127	HRW	7-26-72	9- 1-72	.15	.47	.32	4,840.64
								<u>\$1,659,567.36</u>
<u>5,704,140.29</u>								

^aDark Northern Spring

^bHard Red Winter

^cWestern White

GAO note: Of the 50 cases, 41 were System I registrations and represented 21 registrations or about 3 percent of the System I registrations and 1 percent of the total registrations during July 5 to September 22, 1972. The 50 cases include 9 major exporters of the total of 23 companies that registered during the period and total about 5.7 million bushels.

The cases were developed by randomly selecting registrations by companies and then examining EMS registration files for the necessary sales contract information. The cases were limited principally to System I registrations because Agriculture does not generally require sales contract information for other registrations. The f.o.b. sales prices were taken from exporters certifications submitted to Agriculture in support of claims for subsidy payments. The domestic prices at date of sale were obtained from EMS daily calculations of such prices, brought to an f.o.b. port basis. Subsidy amounts at registration dates reflect the protein content of the wheat shipped.

Cases include registrations by five of the six major exporters involved in the sales to Russia but exclude Russian sales registrations. Three types of wheat eligible for subsidy are also included.

which were in effect previous to the Soviet wheat sales. Calls were made to the following companies and individuals:

Cargill, Inc.—Minneapolis, Minnesota; Mel Middents.
 Cook Industries, Inc.—Memphis, Tennessee; Willard Sparks.
 Bunge Corporation—New York, N.Y.; Henry Becker.
 Dreyfus Corporation—New York, N.Y.; Phil McCall.
 Continental Grain Co.—New York, N.Y.; James Good.
 Garnac Grain Co., Inc.—New York, N.Y.; Dr. Herbert Putz.
 Union Equity Cooperative Exchange—Enid, Oklahoma; Ed O'Rourke.
 Bartlett Grain Co.—Kansas City, Missouri; Abe Malech.
 C. B. Fox Co.—New Orleans, Louisiana; Brook Fox.
 Portland Branch, Kansas City, Commodity Office—Mr. Henry Sakamoto who notified the Japanese trading companies, United Grain, and Pacific Grain Growers, all in Portland, Oregon.

In addition to these calls the Department received calls from the trade regarding this change in policy. Some of these calls were from the following companies: General Mills, Peavy Company, Pillsbury Company, International Multi-foods, National Federation of Grain Cooperatives.

August 25, 1972—USDA announced change in wheat export payment program to meet wheat supply and price situation created by unexpectedly large export sales of U.S. wheat. Announced that exporters would have until September 1 to book wheat export subsidy at special rates (47 cents per bushel on Hard Red Winter at Gulf) on sales made August 24 or before, for which subsidy had not yet been booked.

August 28, 1972—Export payment rate for Hard Red Winter wheat exported from Gulf Coast on sales made after August 25 reduced from 38 to 37 cents, raising U.S. export price to \$1.73¼ and beginning gradual reduction in payment rate.

September 1, 1972—Booking of subsidy under System 1 special rate closed, with total bookings for the five days of 282 million bushels, of which 167 million bushels represented sales to U.S.S.R.

September 22, 1972—Export payment rate reduced to zero on all classes of wheat from all coasts, raising U.S. export price for Hard Red Winter wheat from Gulf to \$2.43½, approximately 80 cents a bushel above pre-August 24 target price.

SOURCE: Provided by Agriculture for Hearings before the Committee on Agriculture and Forestry, United States Senate, February and March 1973, pp. 780 and 781.

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PRINCIPAL OFFICIALS OF
THE DEPARTMENT OF AGRICULTURE
RESPONSIBLE FOR ADMINISTRATION OF
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF AGRICULTURE:		
Earl L. Butz (note a)	Dec. 1971	Present
Clifford M. Hardin	Jan. 1969	Nov. 1971
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS AND COMMODITY PROGRAMS:		
Carroll G. Brunthaver (note b)	June 1972	Present
Clarence D. Palmby	Jan. 1969	June 1972
ADMINISTRATOR, AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE:		
Kenneth E. Frick (note b)	Mar. 1969	Present
EXPORT MARKETING SERVICE:		
Laurel C. Meade, General Sales Manager (note b)	July 1972	Present
Frank G. McKnight, Associate General Sales Manager	Mar. 1969	Present
George S. Shanklin, Assistant Sales Manager (Commodity Exports)	Jan. 1972	Present
ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE:		
Raymond A. Ioanes (note b)	Apr. 1962	Present
ADMINISTRATOR, ECONOMIC RESEARCH SERVICE:		
Quentin M. West	Jan. 1972	Present

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