

GAO

Report to the Chairman, Committee on  
Agriculture, Nutrition and Forestry,  
U.S. Senate

June 1991

# INTERNATIONAL TRADE

## Soviet Agricultural Reform and the U.S. Government Response



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United States  
General Accounting Office  
Washington, D.C. 20548

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National Security and  
International Affairs Division

B-226268

June 28, 1991

The Honorable Patrick Leahy  
Chairman, Committee on Agriculture,  
Nutrition, and Forestry  
United States Senate

Dear Mr. Chairman:

As requested, we are providing information on recent Soviet agricultural reforms and the U.S. government's response to these reforms.

We plan no further distribution of this report until 14 days from the date of this letter unless you publicly announce its contents earlier. At that time, we will send copies to the Secretaries of Agriculture and Commerce and the Office of the U.S. Trade Representative. Copies will also be made available to others upon request.

Please contact me on (202) 275-4812 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in cursive script that reads "Allan I. Mendelowitz".

Allan I. Mendelowitz, Director  
International Trade, Energy,  
and Finance Issues

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# Executive Summary

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## Purpose

Over the years, U.S. agricultural exports have constituted the single most important element in the U.S.-Soviet commercial relationship. Accordingly, there has been much interest in how agricultural reforms attempted in the Soviet Union have affected this relationship. The Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry asked GAO to review (1) recent Soviet agricultural reforms and (2) the U.S. government's response to these reforms.

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## Background

Agriculture is a key sector of the Soviet economy. The Soviet Union is the world's largest producer of wheat and a major producer of potatoes, sugar beets, and cotton. Nevertheless, the Soviet Union must import huge quantities of agricultural products, especially grain, because of serious problems in harvesting, processing, and delivery.

Historically, U.S. agricultural exports to the Soviet Union have fluctuated due to swings in Soviet domestic agricultural production, U.S. foreign policy toward the Soviet Union, and conditions in the world grain market. U.S. agricultural exports to the Soviet Union first reached significant levels in the early 1970s as a result of several factors, including the Soviet Union's desire to upgrade consumer diets. Since 1976 most U.S. agricultural trade with the Soviets has taken place within the framework of Long-Term Bilateral Grain Agreements.

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## Results in Brief

After assuming power in 1985, President Gorbachev advocated reforming the planning and management of all sectors of the Soviet economy, focusing on agriculture as a leading sector in his program. The initial promise of such reform has succumbed to the reality of an agricultural situation of continuing crisis. Despite various reform initiatives, little progress has been made. An ineffective reform strategy, coupled with intractable economic, social, political, and ethnic problems—many of which were inherited—has left Soviet agriculture in disarray.

Since the onset of Soviet agricultural reforms, the United States has continued to ship large quantities of bulk agricultural commodities and some semiprocessed commodities to the Soviet Union, but there has not been much of an increase, relative to prior years, in the export of U.S. high-value products nor in U.S. investments in the food-processing area. This trade relationship has been fostered by a series of U.S.-Soviet Long-Term Bilateral Grain Agreements and further strengthened more recently by the Soviet Union's participation in the Export Enhancement Program. In addition, a total of \$2.5 billion in agricultural export credit

guarantees has been allocated to the Soviet Union for fiscal years 1991 and 1992.

There have been several small-scale initiatives within the U.S. government but no major organized government effort to actively encourage U.S. agribusiness to do business in the Soviet Union. Similarly, there have been a few notable private sector efforts to take advantage of the potentially vast Soviet market, but U.S. agribusiness is generally taking a wait-and-see attitude.

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## GAO's Analysis

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### Soviet Agricultural Reform

Since 1985 the Soviet Union has announced a series of initiatives to reform agriculture, ranging from making changes in land ownership laws to paying farmers hard currency (that is, currency acceptable in world markets) for high quality crops sold to the state in excess of original state-contracted amounts. However, these attempts have not produced substantive results because of (1) a lack of consensus on the direction reform should take; (2) bureaucratic resistance; (3) little autonomy for Soviet farmers contending with difficult supply problems; (4) serious infrastructure problems in transportation, storage, and processing; (5) persistent risk-averse behavior of farm workers; (6) inability to introduce workable price reform; and (7) monetary imbalances in the overall Soviet economy.

The availability of basic food staples, such as potatoes, meat, and bread, is far worse now than before agricultural reforms were initiated. Agriculture, along with the Soviet economy in general, has experienced chronic problems of distorted prices, inefficient enterprises, waste and pilfering at all stages, and ill-considered investments.

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### U.S. Government Response to Soviet Agricultural Reform

Since reforms were initiated, the nature of U.S. agricultural trade with the Soviet Union has remained essentially unchanged. Because of the deterioration of Soviet agriculture, there has been a continued need by the Soviets to import large quantities of grain. Within the framework of the Long-Term Bilateral Grain Agreements, the Soviets imported from the United States about 22.5 million metric tons of wheat and about 49.3 million metric tons of corn during the 5-year period ending September 30, 1990. From 1986 to 1990 U.S. agricultural exports to the

Soviet Union totaled about \$9.8 billion. Since 1987 the Soviets have been recipients of subsidized exports available under the Department of Agriculture's Export Enhancement Program; as of April 25, 1991, they had purchased about 23.4 million metric tons of wheat under the program.

In December 1990 the Secretary of Agriculture announced that, under the Department's Export Credit Guarantee Program (GSM-102), \$1 billion in export credit guarantees would be available for sales of U.S. agricultural commodities to the Soviet Union; these were quickly exhausted. In June 1991, after much deliberation, President Bush approved providing \$1.5 billion in additional credit guarantees to the Soviet Union for the purchase of U.S. agricultural commodities over the next 9 months.

The December 1990 announcement of export credit guarantees represented the administration's first major step toward offering direct financial incentives to U.S. commercial interests and the Soviet Union. This package, along with those extended by other western nations, was intended to assist the Soviets during a food shortage. The extension of credit guarantees was made possible by the Soviet Union's recent record of emigration liberalization. To allow these credit guarantees, President Bush temporarily waived the Jackson-Vanik amendment to the 1974 Trade Act that had made credit guarantees to the Soviet Union contingent upon the enactment into law of liberalized emigration policies.

Questions about Soviet creditworthiness have been raised by executive and legislative branch officials as well as private sector analysts. The extension of U.S. agricultural credit guarantees has been problematic in light of the restriction in title XV of the Food, Agriculture, Conservation, and Trade Act of 1990. This restriction prohibits the Secretary of Agriculture from issuing export credit guarantees to any country that the Secretary determines cannot adequately service the debt associated with such a sale. The act also prohibits the issuance of export credit guarantees for foreign aid, foreign policy, or debt rescheduling purposes. If, due to the Soviet Union's severe economic deterioration, the Secretary of Agriculture had determined that the Soviet Union could not adequately service its debt, the additional \$1.5 billion in agricultural credit guarantees could not have been extended.

Bilateral relations with the Soviet Union have been reassessed by the U.S. administration and the Congress in light of the Soviet Union's mixed response to the internal independence and democracy movements, its collapsing economy, and its deteriorating creditworthiness. There have also been questions about the advisability of extending food

aid to the Soviet Union since its food shortages stem from distribution rather than supply problems. There have been concerns that giving aid in the form of credits could delay economic reform by providing a crutch for the present system. The reassessment has been a sensitive one that has involved balancing U.S. agricultural sector desires, market development concerns, and financial and foreign policy interests.

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### U.S.-Soviet Agribusiness Efforts

There have been several continuing activities and a few new initiatives within the U.S. government aimed at broadening or reassessing the U.S.-Soviet agricultural trade relationship. The Department of Agriculture's Office of International Cooperation and Development has promoted scientific exchanges, and its Foreign Agricultural Service has stationed agricultural attaches in the Soviet Union to provide analysis to the Department. Also, the Commerce Department has a U.S.-U.S.S.R. Working Group on Food Processing. Recently, a team of U.S. agricultural experts was dispatched to the Soviet Union to assess its food distribution system and find ways to improve food availability to the Soviet people.

The U.S. private sector has also been moving slowly to expand the U.S.-Soviet agricultural trade relationship. One effort involves the Food Processing International Trade Council, formed in early 1989 to enhance commercial relations between U.S. food-processing companies and Soviet food enterprises. While the U.S. member companies prefer to sell finished products directly to the Soviets, the Soviets prefer joint ventures in order to gain access to U.S. technology and conserve hard currency. So far, however, few U.S. agribusiness firms have made major investments in the Soviet Union.

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### Recommendations

This report contains no recommendations.

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### Agency Comments

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

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**Abbreviations**

CIA	Central Intelligence Agency
DIA	Defense Intelligence Agency
EEP	Export Enhancement Program
ERS	Economic Research Service
GAO	General Accounting Office
GNP	gross national product
GSM	General Sales Manager
LTA	Long-Term Bilateral Grain Agreement
mmt	million metric tons
USDA	U.S. Department of Agriculture

# Background

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At almost 2.5 times the size of the United States, the Soviet Union has a diverse terrain that includes broad plains west of the Ural Mountains, vast coniferous forests and tundra in Siberia, deserts in Central Asia, and mountains in the South. The climate is mostly temperate to arctic. Only about 10 percent of the Soviet Union's land mass is arable, as compared to about 20 percent in the United States. Some of the Soviet Union's most fertile land lacks adequate water or has an insufficient growing season. Also, there is serious environmental pollution and degradation throughout the Soviet Union.

Nonetheless, the acreage under cultivation in the Soviet Union, about 230 million hectares,<sup>1</sup> is the most extensive of any country in the world. Agriculture is a key sector in the Soviet economy, contributing about one-quarter of gross domestic product and employing one-fifth of the work force. The Soviet Union is the world's largest producer of wheat and one of the world's largest producers of grain.<sup>2</sup> It is also a major producer of potatoes, sugar beets, cotton, and sunflowers. Despite its vast production of crops, however, the Soviet Union is a net importer of food. Its imports average just under \$20 billion per year, about one-half of which is grains and sugar. Imports are largely necessary because the Soviet Union has been unable to efficiently process and distribute what is grown. The problems plaguing Soviet agriculture begin with the harvesting of crops and continue through each step of processing and distribution until delivery to state retail stores. Difficulties associated with harvesting, processing, storage, and delivery combine to produce huge losses after crops are produced.

More than 5 years after President Gorbachev has been in office, Soviet agriculture is in crisis. The Soviet press reported in August 1990 that although the country's harvest of grain crops was considerably bigger than that of the previous year, the rates of grain purchases by the state were appreciably lower. The bumper grain crop had turned into a harvesting crisis of monumental proportions. Tens of millions of tons of grain were reported to be lying in the fields. The Soviet press contained many accounts of how and why much of the unprecedented grain harvest of 1990 fell by the wayside. Farm worker shortages, lack of basic farm equipment, and chaotic mismanagement compounded existing infrastructure problems. Attempts were made to marshal the resources of the military to assist in transporting the harvested crops. According

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<sup>1</sup>One hectare equals 2.47 acres.

<sup>2</sup>The Soviet Union and China alone account for 25-30 percent of world wheat and feed grain trade.

to one Soviet expert, the Council of Ministers of the Soviet Union allocated an estimated 46,000 military trucks for transporting crops. Thousands of trucks, however, could not move due to shortages of gasoline and spare parts. At the same time, transportation and storage resources were overwhelmed by the need to transport imported grain arriving at ports at the height of the harvest. In the Russian Republic, 22 million metric tons (mmt)<sup>3</sup> of uncollected grain was left to rot outdoors at collective and state farms. The press reported that one explanation for the decreasing sales of grain from domestic producers to the state was that grain was being hoarded on collective farms. Severe shortages of fodder led many farmers to save grain to feed their livestock. Another reported problem was the unwillingness of state and collective farms to sell contracted amounts of grain to the state procurement agencies; rather, grain was being bartered, sold on the black market, or kept on the farms to feed livestock.

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## Objectives, Scope, and Methodology

The Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry asked us to conduct a review of recent Soviet agricultural reforms and the U.S. government's response to changes in Soviet agricultural policies. In this report, we review the progress of Soviet agricultural reform and the extent of U.S. government activities with respect to the changes in Soviet agriculture.

To gain an insight into the progress of agricultural reform in the Soviet Union, we conducted interviews with U.S. government officials from the Department of Agriculture's Foreign Agricultural Service, its Office of International Cooperation and Development, and its Economic Research Service (ERS). We also interviewed officials at the Commerce Department, the Office of the U.S. Trade Representative, and the Office of the Special Assistant to the President on Agricultural Trade and Food Aid. In addition, we interviewed U.S. trade association representatives, grain company executives, and academic experts on Soviet agriculture. We attended several conferences on Soviet agricultural reform, including those sponsored by Harvard University's Russian Research Center in Cambridge, Massachusetts, and the Woodrow Wilson Center and the American Farm Bureau in Washington, D.C.

We reviewed relevant documents and studies from a variety of sources, including the U.S. Department of Agriculture (USDA) and its Economic

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<sup>3</sup>One metric ton equals 1.1 tons.

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Research Service, the U.S. Department of Commerce, the Library of Congress' Congressional Research Service, the Congress' Joint Economic Committee, the International Monetary Fund, the Special Assistant to the President for Agricultural Trade and Food Aid, Harvard's Russian Research Center, Soviet press reports, and analyses by Soviet academic experts. We also reviewed published documents of the Central Intelligence Agency (CIA) and the Defense Intelligence Agency (DIA).

We conducted our work from April 1989 to June 1991 in accordance with generally accepted government auditing standards.

As requested, we did not obtain written agency comments on a draft of this report. However, we discussed it with officials from the Departments of Agriculture and Commerce, and their views have been incorporated where appropriate.

# President Gorbachev's Attempted Agricultural Reforms

When President Gorbachev came to power in 1985, he targeted agricultural reform in the Soviet Union as one of his prime concerns. In order to achieve this goal, he attempted to restructure investments, streamline the bureaucracy, and improve economic incentives. Despite these attempted reforms, food shortages have continued, in part due to the deterioration of the Soviet economy in general. Current problems endemic to both the overall economy and the agricultural sector in particular include confusion about the direction of reform; bureaucratic resistance to change; limited autonomy for Soviet farmers, who also encounter difficulties in getting supplies; infrastructure deficiencies; and farmers' unwillingness to take risks. Also, the Soviet leadership has been unable to introduce workable price reform; therefore, monetary imbalances remain, hindering the development of market-determined prices.

## Initial Agricultural Reform Objectives

The Soviet Union's agricultural problems were not new to President Gorbachev when he assumed leadership of the Soviet Union. As former Premier Brezhnev's agriculture secretary, President Gorbachev was a major architect of Premier Brezhnev's unsuccessful 1982 Food Program, which sought to reform agriculture through shifting investments within the agro-industrial sector.<sup>1</sup> President Gorbachev hoped to move more quickly than the Food Program had in changing investments within agriculture. He also advocated modifying the organizational structure of the Food Program and placing greater emphasis on economic incentives as a means of increasing efficiency. A CIA study<sup>2</sup> noted that President Gorbachev was consistently unwilling, however, to make substantial breaks from the failed approaches of the past.

The overall objective of President Gorbachev's agricultural strategy was to improve the quality and quantity of food available to the people of the Soviet Union. According to the CIA paper, President Gorbachev's agricultural policies had several goals. A key goal was to shift investment from farm production into rural infrastructure development (e.g., housing, roads, and storage facilities), food processing, agricultural

<sup>1</sup>Soviet experts have concluded that the Food Program was largely unsuccessful. Reorganization measures were described as misguided and cumbersome. Also, according to a published CIA document, the program failed to come to grips with the more fundamental problems of linking rewards to performance, giving farms freedom to make production decisions, and instituting a market-oriented price system. See a paper prepared by Penelope Doolittle and Margaret Hughes, *Gorbachev's Agricultural Policy: Building on the Brezhnev Food Program*, Central Intelligence Agency, Office of Soviet Analysis, for presentation to the Joint Economic Committee, Congress of the United States (Washington, D.C.: Nov. 23, 1987).

<sup>2</sup>Penelope Doolittle and Margaret Hughes, *Gorbachev's Agricultural Policy*.

machinery, and chemicals. A second major goal of the reform program was to restructure the agro-industrial bureaucracy to eliminate duplication and interdepartmental conflicts. Finally, economic incentives were to replace administrative means in order to enhance agricultural enterprise activity.

Restructuring investments. This strategy sought to concentrate resources where they would best improve efficiency and reduce waste. President Gorbachev advocated a more rapid shift away from the traditional concentration of resources on farm production to industries that supplied the farm sector with farm machinery, storage, transportation, food processing, and housing. Storage capacity was to be built on farms and in food-processing enterprises. Farms were to receive more storage capacity for perishable inputs such as fertilizer and livestock feed. The plan for improving transportation was centered on expanding and bettering the network of interfarm and farm-to-market roads and providing more vehicles such as refrigerator trucks, milk tankers, and cattle trailers. In the 1986-90 Five Year Plan, the highest priority was assigned to upgrading food-processing and packaging equipment.

Streamlining the bureaucracy. President Gorbachev viewed the central bureaucracy, with its organization along narrow departmental lines, as the main obstacle to his plans to redirect investments, resolve inter-branch conflicts, and transfer greater authority to the regional and local levels. His November 1985 decree established the State Agricultural Commission (Gosagroprom), whereby five government ministries involved in agriculture were consolidated into a single entity. Gosagroprom was to have broad authority over all components of the agro-industrial sector. The reorganization was accompanied by a major cut in administrative staff. Almost one-half of the personnel in the central bureaus of the abolished agriculture ministries were either transferred to jobs at the production level or laid off.

Improving economic incentives. President Gorbachev emphasized that changing the role of government ministries and giving regional organizations and farms greater autonomy could not be fully accomplished without stronger economic incentives. He believed that the main vehicle for creating positive incentives for producers should be self-financing, i.e., requiring enterprises to finance their operations out of their own revenues. He argued that the practice of automatically rescuing economically troubled farms bred irresponsibility.

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## Agricultural Reforms Undertaken by President Gorbachev

In his March 1987 report to the 27th Party Congress, President Gorbachev announced a plan to give regional party officials and farms greater control over the distribution of above-plan production and to allow the sale of more produce, particularly perishables, at market prices. Production in excess of state quotas was to be disposed of at the discretion of individual farmers—either held for internal use or sold on the collective farm market, sold through the consumer cooperative network, or sold to state procurement agencies. According to the CIA document, however, farm autonomy was not enhanced in any significant way. Farms were to continue to receive plans for sales, investment quotas, and input deliveries. Elements that tended to undermine self-financing, such as minimum wages and measures to bail out unprofitable farms, were to be preserved.

At a March 1989 meeting of the Communist Party Central Committee, in an attempt to stimulate agricultural production, long-term leasing of state-owned land to peasants was legalized. It should be noted that since 1987 the possibility of a program for leasing land and other agricultural assets had been stressed. President Gorbachev championed the idea of lease terms in agriculture, whereby individuals or small groups of individuals would lease land and other assets from the state, but offered little in the way of new incentives to encourage its adoption. Under this system, state and collective farms, which controlled virtually all available agricultural land in the Soviet Union, were permitted to lease land to individuals or groups of individuals, usually people from the cooperatives, and contract for sales of specific agricultural commodities. He indicated that within 2 to 3 years, farms would have much greater latitude in determining what commodities to market and how to market them.

At the same March 1989 meeting, President Gorbachev announced the reorganization and downscaling of the administrative apparatus at the national level, thus giving more powers to the 15 individual republics. Gosagroprom was ordered dismantled, therefore signaling a failure of the attempt to streamline the agricultural bureaucracy. Gosagroprom was replaced later that year by a new, significantly smaller State Commission for Food and Procurements associated with the Council of Ministers. The new Commission would surrender planning and management powers back to other bodies, such as the State Price Committee, the Ministry of Finance, the State Planning Committee, and the republics. This Commission was formed and disbanded within 6 months and its responsibilities transferred to the Ministry of Agriculture.

In August 1989 the Council of Ministers adopted a decree authorizing payment of "convertible rubles" to farms for certain sales of wheat and other agricultural crops to the state. The trial program was to be in effect for 1989-90. To qualify for the hard currency rubles, farms had to meet specific production, procurement, and quality criteria. The convertible rubles were to be used to purchase foreign consumer goods and farm equipment and supplies. The program was designed to raise domestic purchases and reduce expensive grain and oilseed imports. By paying Soviet farmers for grain at prices below the cost of imported grain, it was hoped that scarce hard currency would be saved. The incentive program was largely unsuccessful in increasing deliveries to the state. According to the ERS, as of January 1, 1990, only about 225,000 tons of wheat had been sold to the state, far below the 10 million-15 million tons the state wanted, and only about 11 million rubles had been paid out. The poor response to the program reflected delays in its introduction, poor implementation and administration, continued distrust by farms of state promises, inadequate price incentives, and excessive restrictions connected with the disposal of hard ruble earnings.<sup>3</sup>

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## The Deterioration of Agriculture in Perspective

The 1990 harvest in the Soviet Union was the second largest harvest ever (the first was in 1977-78). Yet there was a food shortage throughout the Soviet Union, most notably in urban centers, which necessitated the continued importation of large quantities of food. As with other sectors of the Soviet economy, agriculture has had chronic problems of distorted prices, inefficient enterprises, waste and pilfering at all stages, and ill-considered investments with poor returns. The problems that have contributed most directly to the deepening Soviet food crisis do not primarily involve agricultural production. Rather, they are the result of recent and more general wage, price, monetary, and subsidy policies that have affected demand for and distribution of goods throughout the economy.<sup>4</sup> According to the ERS, through 1990 President Gorbachev's food reforms have been concerned with supply rather than demand factors. As a result, Soviet supply-side reforms have helped increase production and productivity, while demand-side policies have worsened the balance in the food economy. Under Gorbachev, production of most agricultural goods has not fallen.

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<sup>3</sup>USSR: Agriculture and Trade Report, Situation and Outlook Series, U.S. Department of Agriculture, Economic Research Service, (Washington, D.C.: May 1991).

<sup>4</sup>Economies in Transition: China, Soviet Union, East and Central Europe, Centrally Planned Economies Agriculture Report, U.S. Department of Agriculture, Economic Research Service, Vol. IV, No. 1 (Washington, D.C.: Jan./Feb. 1991).

Between 1986 and 1990 average annual grain and meat output equalled 213 million tons and 19.3 million tons, respectively, compared to 180 million tons and 16.2 million tons during 1981-1985. However, the productivity of Soviet agricultural inputs (especially labor and capital) remains much lower than in the West, and a large share of agricultural output is lost to waste. The current production and distribution systems cannot satisfy the overstimulated demand and the consumption that remains near western levels.<sup>5</sup> True market reform could greatly increase Soviet agricultural production and productivity while responding to consumer demand for food, thus decreasing the need for agricultural imports. Meanwhile, the Soviet Union continues to need to import huge amounts of agricultural products.

The agricultural sector's problems were particularly apparent in 1990 when the deterioration in marketing, transportation, and distribution throughout the economy prevented the Soviets from efficiently processing and distributing the large production of food grown, which aggravated food shortages in major cities. In a study by the International Monetary Fund and others,<sup>6</sup> it was noted that substantial food losses occurred because of shortages of packaging material and storage facilities, outdated processing technology, and inadequate and unorganized transport systems. The study indicated that wastage and losses were roughly equal to imports. Waste of perishable foods, such as fruits, vegetables, and potatoes, was estimated to be as much as 40 percent of the crop. The increase in barter between republics and the republics' desire for self-sufficiency was particularly damaging for agriculture, according to the International Monetary Fund study. In a broader sense, however, the shortages were a consequence of growing price distortions and macro-imbalances.

The crisis in agriculture must be put in the perspective of the crisis in the Soviet economy in general. A January 1991 Congressional Research

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<sup>5</sup> According to an ERS analyst, per capita consumption levels of flour, vegetables, melons, potatoes, and eggs are higher in the Soviet Union than in the United States. Per capita consumption of meat in the Soviet Union is close to that of some developed Western European countries such as the United Kingdom and Sweden. The per capita level of calorie intake is almost the same as that of the United States.

<sup>6</sup> "A Study of the Soviet Economy," *The Economy of the USSR*, International Monetary Fund, International Bank for Reconstruction and Development, Organization for Economic Cooperation and Development, and European Bank for Reconstruction and Development, Vol. 3 (a study undertaken in response to a request by the Houston Summit, Feb. 1991).

Service report<sup>7</sup> described the Soviet economic crisis as a breakdown or collapse. The report noted that declines of the magnitude occurring in the Soviet Union were unprecedented in major nations since World War II and were similar to the global depression in the West during the 1930s. The report enumerated several crises threatening the Soviet regime: These included (1) the diminishing value of the ruble as a medium of exchange, with prospects of hyperinflation; (2) shortages of food, especially in major cities, and of energy and consumer goods; (3) a deterioration in the quality of life, including health, environment, and housing; (4) the attempt of various ethnic groups to break away from central control; and (5) a reduction in confidence, trust, and responsiveness to the Soviet leadership.

A recent analysis<sup>8</sup> prepared by the CIA and the DIA attributed the economy's deterioration largely to the chronic weaknesses of the central planning system, compounded by partial and ad hoc economic reforms, policy mistakes and mismanagement, excessive growth in the money supply, and regional protectionism.

The current year promises to be a worse one for the Soviet economy than 1990. Western and Soviet sources indicate that the Soviet gross national product (GNP) probably declined in 1990 and may fall to a much greater extent in 1991. In addition, the Soviet Union is increasingly unable to service its rising hard currency debt, which is reflected in the substantially lower credit ratings the Soviet Union received from leading international banks during the past year. If economic reform is further delayed, the Soviets face a future of seemingly endless and worsening crises.

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## **Key Problems Plaguing Soviet Agriculture**

An ineffective agricultural reform strategy, coupled with intractable economic, social, political, and ethnic problems, many of which were inherited, has resulted in the crisis state of Soviet agriculture today. Key problems in Soviet agriculture have included several that are specific to agriculture and several that apply to the Soviet economy overall. These problems involve at least seven elements.

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<sup>7</sup>John P. Hardt, *Western Aid Report on the Soviet Economy*, Congressional Research Service, the Library of Congress, 91-16 RCO (Washington, D.C.: Jan. 8, 1991).

<sup>8</sup>*Beyond Perestroika: The Soviet Economy in Crisis*, A paper prepared by the Central Intelligence Agency and the Defense Intelligence Agency for presentation to the Technology and National Security Subcommittee of the Joint Economic Committee, Congress of the United States, (Washington, D.C.: May 14, 1991).

Confusion about the direction of reform. The Soviet leadership has been unable to communicate a clear sense of the direction of agricultural reform. The first reorganization of the agricultural bureaucracy under President Gorbachev, which created Gosagroprom in 1985, caused confusion among the ranks of government officials. The functions of the subdivisions within Gosagroprom and the duties of each worker had not yet been clearly defined, resulting in a lack of coordination and efficiency and an unwillingness on the part of many specialists to accept responsibility for resolving questions.<sup>9</sup> Similarly, the second reorganization in 1989, which dismantled Gosagroprom, reportedly threw the bureaucracy into disarray. In an August 1989 report the Special Assistant to the President for Agricultural Trade and Food Aid noted that "at least temporarily, an impediment to progress seems to be uncertainty as to who is in charge of Soviet agriculture."<sup>10</sup>

Bureaucratic resistance. President Gorbachev has had great difficulty in motivating mid-level bureaucrats to implement his desired changes, due, in part, to their vested interest in the status quo. Many bureaucrats have feared a loss of their jobs if farmer autonomy increased. This problem has been compounded by the immense size of the bureaucracy supervising agriculture, estimated at about 3 million people,<sup>11</sup> and the powerful role played by the local Communist party apparatus throughout the Soviet Union, especially in the agriculture sector.

Little autonomy for Soviet farmers contending with serious supply problems. President Gorbachev sought to encourage individual farmers to lease land from the state and farm their own plots. While on paper such leased plots may have appeared free of bureaucratic control, in practice farmers have had very few decision-making powers. Rather, they have had to follow the dictates of local party officials who control farm resources.

Managers of collective and state farms have been under great pressure to meet production quotas while contending with severe shortages of

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<sup>9</sup>Doolittle and Hughes, Gorbachev's Agricultural Policy.

<sup>10</sup>Cooper Evans, "Opportunities for Increasing U.S.-U.S.S.R. Agricultural Trade and Cooperation," (A special report included as a supplement to the annual report of the Special Assistant to the President for Agricultural Trade and Food Aid: Aug. 15, 1989).

<sup>11</sup>There were roughly 3 million people involved in administrative supervision of agricultural production in the Soviet Union in 1989 according to the Special Assistant to the President for Agricultural Trade and Food Aid. By comparison, there were only about 2 million farmers in the United States in that year.

labor and materials. The Soviet press has reported on the shortage of labor and on the lack of farm machinery, spare parts, and fuel. Labor shortages were reportedly so great in 1990 that farmers in several regions threatened not to provide food to nearby cities if factory workers were not reassigned to work in the fields. The labor shortages particularly affected difficult-to-harvest crops such as fruits, vegetables, and sugar beets.

Fertilizers, too, have been in chronic short supply. Although the Soviet Union is the world's largest producer of mineral fertilizers, phosphorous fertilizers are often unavailable. More than 3 million tons of mineral fertilizers, or 10 to 15 percent of deliveries to agriculture, are lost annually due to deficiencies in specialized technology and violations of regulations for transporting, loading and unloading, and storage.

Serious infrastructure problems in transportation, storage, and processing. Serious transportation deficiencies, such as poor roads and lack of vehicles, are compounded by illogical transport planning. For example, livestock that could be slaughtered and eaten locally are transported hundreds of miles away because of outdated subsidy programs and unrealistic planning. Transportation bottlenecks have prevented large shipments of grain from being delivered. The press has reported ports clogged with undelivered grain shipments. This bottleneck was particularly problematic in 1989-90. Allegedly, huge amounts of imported grains have been wasted, never reaching the market, thereby causing shortages of bread in Soviet stores. In July 1990 there were reports of Moscow railroad terminal tracks being clogged with cars that had not been unloaded. Soviet press reports also indicated that during December 1990 even foreign food aid or food purchased through credit packages remained in storehouses in the West for lack of adequate transport.

The Soviet Union has only limited facilities for storing, cleaning, processing, and distributing agricultural products. As a result, crops often rot in the field. For example, although 36 mmt of grain had been threshed by August 1990 in the Russian Republic, only 14 mmt were delivered to state storehouses. The rest had piled up at collective and state farms due to overloaded grain elevators.

Persistent risk-averse behavior of farm workers. A major obstacle to the success of agricultural reform has been the hesitancy of farm workers to take risks. According to an ERS official, farm workers have been manipulated by the government so many times in the past that they distrust the

system. Some farm workers have been reluctant to take a chance on becoming independent because of the potential for future political reprisals for those who do succeed. There has also been a fear of sabotage by less successful, envious neighbors. Successful farmers and small entrepreneurs have been plagued by such things as slashing of combine tires and burning down of storage sheds. After decades of anticapitalist indoctrination, many Soviets have equated private enterprise with worker exploitation and criminal activity.

Although President Gorbachev has been stressing the possibilities of leasing arrangements in agriculture since 1987, few people have been willing to forgo the largely guaranteed income or salaries of state and collective farms for the risks of a leasing arrangement. Many potential lessees fear a reversal of the policy and an unwillingness by authorities to adequately reward hard work. Under the system where small groups of individuals lease land and other assets from the state, such lease teams are fully dependent on the farms to obtain inputs and services and must satisfy minimum contract deliveries at prices lower than the farm receives when it sells to the government.

Inability to introduce workable price reform. Soviet economists and many political leaders generally acknowledge the necessity for far-reaching price reform. Under the present system, it has been virtually impossible for farmers to realize profits because the inflated prices farmers pay for their inputs have often exceeded the fixed amount the state pays for the purchase of the crops. But the prospect of price reform has confronted the Soviet leadership with a fundamental dilemma. There has been great concern that price rises could lead to serious social unrest. Without price reform and a convertible ruble, many believe it is unlikely that the Soviet Union can improve its agricultural situation.

Artificially low retail prices have entailed massive consumer subsidies. Agricultural subsidies have grown progressively since the mid-1970s. For example, from 1966 to 1970 government subsidies for meat and poultry averaged about 3.6 billion rubles per year. By the late 1980s such subsidies had grown to over 70 billion rubles annually.<sup>12</sup> In 1989 the subsidy was budgeted at 95 billion rubles but cost 115 billion rubles.

Monetary imbalances in the overall Soviet economy. An ERS analyst noted in January 1991 that levels of Soviet food consumption are not all

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<sup>12</sup>This data is reported in current year rubles and does not reflect the effects of inflation.

that unfavorable even compared to developed countries. Rather, recent wage, price, monetary, and subsidy policies have been wreaking havoc on demand and distribution of goods throughout the economy. The 1990 food shortages have simply been the most prominent and politically serious manifestation of those policies. According to the ERS, average monthly wages had increased 42 percent during the period from 1985 to 1990, while labor productivity grew only 7 percent.<sup>13</sup> The result has been strong inflationary pressure. Rather than face the political fallout from open price inflation, the Soviet government opted for repressed inflation, especially for foodstuffs. Shortages have been exacerbated as a result. At low prices, demand for more foodstuffs, especially meat, is greater than the government's supply available for sale. Soviet estimates of the surplus purchasing power of Soviet consumers have ranged between 150 billion and 300 billion rubles, an amount commonly identified as the "monetary overhang." According to the ERS report, this large overhang has created the Soviet economy's most serious immediate problem, the decline of the ruble as an accepted means of exchange. In an economy plagued by excess demand, access to goods rather than availability of money has become a decisive factor in purchasing ability. As money has become less useful as a means of exchange, inefficient barter has grown throughout the economy at the personal, enterprise, regional, and republic level.

The report noted that a corollary development to barter has been hoarding, as goods themselves become the main store of value. According to one Soviet economist, surveys indicated that 83 percent of the population has food stocks 2 to 4 times in excess of need. In 1991, in an attempt to rein in excess demand, the government increased retail food prices 1 or more times and tried to introduce other monetary policies to contract the money supply.

Another consequence of the decline of the ruble has been the increasing "dollarization" of the economy. Hard currency is becoming necessary for many transactions, for Soviets as well as for foreigners.

A consequence of the shortages in the Soviet economy has been a growing black market and, according to the ERS, a blurring of the distinction between legal and illegal activity. The report concluded that while partial reforms under President Gorbachev had moved the Soviet economy toward a freer, more money-based market system, fears of

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<sup>13</sup>USSR: Agriculture and Trade Report.

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**Chapter 2**  
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future inflationary pressure were inhibiting the government from developing the key ingredient of a market economy—market-determined prices.

# U.S.-Soviet Agricultural Trade

Since 1972, when the Soviet Union decided to upgrade its consumer diet, the Soviet Union has been a major customer for U.S. bulk agricultural commodities, although these exports have fluctuated greatly from year to year. This trade relationship has been fostered by a series of U.S.-Soviet Long-Term Bilateral Grain Agreements (LTA) and further strengthened by the Soviet Union's participation in the USDA's Export Enhancement Program (EEP). In addition, \$1 billion in export credit guarantees under USDA's Export Credit Guarantee Program (GSM-102)<sup>1</sup> has been provided, and the offer of an additional \$1.5 billion in export guarantees was announced June 11, 1991. Annual sales have varied in response to a variety of factors, including fluctuations in Soviet agricultural production, the nature of the U.S.-Soviet political relationship, and competition from other exporters of agricultural commodities. U.S. policymakers have tended to view expanded bilateral commercial relations as contingent upon progress in security, political, and human rights issues. Others, particularly in the private sector, have argued that the United States should deal with bilateral trade issues on a strictly commercial basis.

## U.S. Government's Response to Soviet Agricultural Reform

The present U.S. administration has stated its support for President Gorbachev's perestroika measures and fundamental economic reform objectives in the Soviet Union. Initial optimism regarding President Gorbachev's attempts at reforming Soviet agriculture and the economy in general led some to believe that agricultural trade between the Soviet Union and the United States might increase. However, the Soviet Union's continued need to import huge quantities of grain and other agricultural commodities has occurred in spite of, rather than as a consequence of, its agricultural reforms. The deteriorating Soviet economy and the systemic problems of its agricultural sector have perpetuated food shortages. The United States has responded to the food shortages by augmenting its exports under the LTAs with subsidized commodities under EEP and export credit guarantees under GSM-102. According to the White House press secretary, the recent allocation of an additional \$1.5 billion in agricultural export credit guarantees reflects the administration's desire to promote a continued positive evolution in the U.S.-Soviet relationship.

<sup>1</sup>The GSM-102 program is a short-term export loan guarantee program for transactions with repayment periods of 6 to 36 months. The GSM-103 program is an intermediate loan guarantee program for transactions with repayment periods of more than 3 but not more than 10 years.

## U.S.-Soviet Agricultural Trade Statistics

Despite the existence of long-term grain agreements and the Soviet Union's recent participation in EEP and GSM-102, the agricultural trade relationship between the United States and the Soviet Union has not changed significantly. The U.S. trade relationship with the Soviet Union continues to be largely unilateral: The United States exports large quantities of bulk agricultural commodities and some semiprocessed commodities to the Soviet Union, and the Soviets export relatively small quantities of goods to the United States. (See table 3.1.) Recently, the Soviet Union has increased its purchases of U.S. value-added products.

**Table 3.1: U.S. Trade With the Soviet Union, 1972-1990**

Dollars in millions

	U.S. Exports to the Soviet Union			U.S. imports from the Soviet Union	
	Total exports	Agricultural exports	Agricultural exports as a percentage of the total	Total imports	Agricultural imports
1972	\$572	\$459	80	\$88	\$4
1973	1,287	1,017	79	204	5
1974	631	324	51	335	9
1975	1,871	1,170	63	243	7
1976	2,424	1,605	66	214	8
1977	1,637	1,053	64	221	11
1978	2,328	1,765	76	529	12
1979	3,749	3,000	80	873	15
1980	1,601	1,138	71	432	10
1981	2,450	1,685	69	357	12
1982	2,605	1,871	72	229	11
1983	2,002	1,473	74	341	10
1984	3,343	2,878	86	556	11
1985	2,460	1,923	78	407	9
1986	1,257	658	52	557	17
1987	1,492	938	63	408	22
1988	2,849	2,246	79	564	19
1989	4,412	3,597	82	691	20
1990	3,092	2,262	73	1,032	17

Source: Economic Research Service data.

The Soviet Union has been an important but somewhat volatile market for U.S. agricultural exports. During the 1980s the Soviet Union's annual imports fluctuated between a low of 15.4 percent and a high of

26.5 percent of world wheat and feed grain trade and between 6.5 percent and 23.5 percent of U.S. trade. During this time annual imports averaged 18.9 percent of world trade and 13.8 percent of U.S. trade. Until 1983 agricultural trade with the Soviet Union principally consisted of wheat and corn exports. By 1989 U.S. agricultural exports to the Soviet Union had expanded, accounting for about 9 percent of U.S. agricultural exports in that year and about 6 percent in 1990. In 1989 the Soviet Union was second only to Japan as a market for U.S. agricultural exports.

Over the past 20 years the Soviet Union's import practices have been a significant variable factor in the world grain markets. The Soviet Union's high level of annual imports continues to influence world grain markets and U.S. market and policy operations. There has been a relationship between reduced U.S. exports to the Soviet Union and poor performance in the U.S. farm sector. Conversely, large exports to the Soviet Union have contributed to higher U.S. farm prices and reduced government outlays and food stocks.

In the last several years the Soviet Union has put a higher priority on nonfood imports. Because the government is attempting to ease shortages of consumer goods and because enterprises are exercising their newly acquired rights to buy directly from western businesses, hard currency imports jumped more than 50 percent from 1987 to 1989 and continued to climb in the first half of 1990. The Soviet Union's hard currency exports also rose but could not keep pace with imports, which turned its \$11.5-billion trade surplus at the beginning of 1988 to more than a \$5-billion deficit at the beginning of 1990. In 1990 Soviet hard currency grain imports accounted for about 10 percent of total hard currency imports. The share of total agricultural hard currency imports was 20-25 percent, well below the peak in 1981 of 42 percent.

U.S. agricultural exports to the Soviet Union in calendar year 1990 declined 37 percent from 1989's record \$3.6 billion. In 1990, as in previous years, U.S. agricultural exports to the Soviets consisted largely of wheat, corn, soybeans, and soybean meal, all commodities that were purchased in accordance with the grain agreements (see table 3.2). Grain and soy product exports accounted for 90 percent of U.S. agricultural exports to the Soviet Union, despite large sales of poultry and butter. In 1990 the U.S. share of Soviet agricultural imports fell to 12 percent, in part because of lower Soviet grain purchases and higher nongrain expenditures, especially for high-priced sugar from Cuba. U.S.

nonagricultural exports to the Soviet Union changed little, and U.S. agricultural imports from the Soviet Union fell 14 percent, to \$17 million.

**Table 3.2: U.S. Agricultural Exports to the Soviet Union, 1987-1990**

Dollars in millions				
Commodity	1987	1988	1989	1990
Wheat	\$393	\$755	\$827	\$543
Corn	393	962	2,135	1,095
Soybeans	43	164	82	61
Soybean meal	58	246	389	338
All other	52	125	164	226
<b>Total</b>	<b>\$938</b>	<b>\$2,252</b>	<b>\$3,597</b>	<b>\$2,262</b>

Note: Columns may not add due to rounding.

Source: Economic Research Service data.

## Long-Term Bilateral Grain Agreements

Long-Term Bilateral Grain Agreements provide a framework within which to negotiate specific contracts for trade. Despite a slight decline since 1985, due in large part to the oversupply of grain in the world markets, the use of long-term grain agreements by major U.S. competitors remains an important aspect of international grain trade. LTAs account for approximately 20 percent of U.S. agricultural exports. Countries enter into LTAs for a variety of reasons, such as (1) limiting uncertainty and stabilizing markets, (2) facilitating planning and permitting diversification of suppliers, (3) gaining information on and access to markets, and (4) strengthening political and economic ties. On the other hand, countries may be reluctant to enter into LTAs because such agreements may inhibit nations' abilities to react to marketplace changes.

The U.S.-Soviet Long-Term Bilateral Grain Agreements have provided the framework under which most agricultural trade between the two countries has taken place.<sup>2</sup> Since 1975 the United States has signed three LTAs and several extensions with the Soviet Union. The United States has entered into the LTAs with the Soviet Union to minimize market disruptions, stabilize U.S. domestic prices, promote an orderly expansion of trade between the two countries, and enlarge an agricultural export market with a potentially large customer.

Under the provisions of the LTAs, the Soviet Union agrees to purchase minimum quantities of wheat and corn from the United States; in return,

<sup>2</sup>See Agricultural Trade: Long-Term Bilateral Grain Agreements With the Soviet Union and China (GAO/NSIAD-89-63, Mar. 22, 1989).

the U.S. government agrees to facilitate the sales of those commodities at prevailing market prices for a set number of years. Actual sales under the agreements are to be transacted between private U.S. grain traders and Soviet government buying agencies. The LTAs compel the United States and the Soviet Union to hold biannual grain consultations. In fulfillment of this requirement, USDA officials meet with their Soviet counterparts to discuss the terms of the agreement currently in effect, extensions of the agreement, and issues involved in negotiating a new agreement.

During the initial 3 years of the first LTA, U.S.-Soviet grain trade ran relatively smoothly; however, this trade was affected by U.S. national security and foreign policy concerns during the last 2 years. In 1980, in response to the Soviet invasion of Afghanistan in December 1979, President Carter announced a partial grain embargo: Soviet purchases were limited to 8 mmt, the maximum amount guaranteed under the LTA. The partial embargo was maintained until April 1981, when it was lifted by President Reagan.

Although the embargo may have had some symbolic value, its success was limited because the Soviets were able to purchase needed grain from other major producers, including Argentina, Australia, Canada, and the European Community. The embargo was not without costs to the United States. The USDA's Economic Research Service estimated the gross cost of the embargo to the U.S. government at over \$2 billion but the net cost was lower due primarily to the subsequent resale of contracts purchased from grain companies.<sup>3</sup> More significantly, the embargo disrupted grain trade patterns as the competing producers attempted to maintain their increased shares of the Soviet market. Not only did the U.S. reputation as a reliable supplier of agricultural commodities to the world markets suffer, but the embargo encouraged other competitor countries to increase agricultural production and exports. Although the embargo was eventually lifted and a second LTA signed in 1983, the U.S. share of the Soviet market remained well below the level of the late 1970s—until 1984 in the case of corn and 1988 in the case of wheat. Prior to the embargo, the United States had between 32 and 73 percent of the Soviet import market, annually. After the embargo, the U.S. share of the Soviet grain market fluctuated between a low of 6.5 percent and a high of 23.5 percent.

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<sup>3</sup>Embargoes, Surplus Disposal, and U.S. Agriculture: A Summary, U.S. Department of Agriculture, Economic Research Service, Agriculture Information Bulletin No. 503 (Washington, D.C.: Nov. 1986).

Despite the many mutual benefits of LTAs, U.S. and foreign officials generally agree that trade depends on price, quality, and incentives offered. LTAs have a negligible impact on grain and price availability because importers usually pay prevailing market prices for grain whether or not it is purchased through LTAs.

In 1985 and 1986 the Soviets were reluctant to buy minimum quantities of U.S. wheat under the 1983 agreement due to the large variances between the U.S. and world market prices. The Soviets had been successful in buying wheat on the world market from foreign competitors at prices well below those offered by U.S. suppliers. The Soviet Union's grain purchases from the United States did not pick up until it began participating in the Export Enhancement Program in 1987. In 1989-90 the Soviet Union did not fulfill the terms of the interim grain agreement for wheat, and in market year 1990-91 sales started slowly because the Soviet Union anticipated a large grain harvest and campaigned for concessionary terms in the competitive agricultural export markets.

In March 1990 the United States and the Soviet Union agreed to their third 5-year grain agreement. It was signed during the May-June 1990 Houston Summit and went into effect on January 1, 1991. The terms of the new agreement represent some changes from the past. The 1990 agreement gives the Soviet Union permission to buy as much as 14 mmt of grain a year without further discussion with U.S. officials. This amount represents a 17-percent rise from the previous limit of 12 mmt. The agreement also provides for an 11-percent increase in minimum annual U.S. grain shipments, to 10 mmt. Under this agreement, the Soviet Union will annually purchase at least 4 mmt each of wheat and feed grains, including corn, with the balance consisting of wheat, feed grains, soybeans, or soybean meal. The agreement also allows greater flexibility for the Soviet Union, permitting more year-to-year freedom of choice in the balance of wheat and feed grains that the Soviets buy from the United States. In any 1 year, the Soviets can substitute up to 750,000 tons of one commodity for the other.

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## The Export Enhancement Program

Established in May 1985, the Agriculture Department's Export Enhancement Program provides government-owned surplus agricultural commodities as bonuses to U.S. exporters to help lower the export prices of U.S. agricultural commodities and make them competitive with subsidized foreign agricultural exports. The program is designed to increase

U.S. exports and encourage U.S. trading partners, particularly the European Community, to undertake serious negotiations on liberalizing agricultural trade. In the last several years U.S. agricultural exports have increased in certain markets. However, the program's effects cannot be easily isolated from those of other policy and economic variables that have contributed to increased agricultural exports.

For foreign policy reasons, the Soviet Union was initially excluded from participating in the EEP. While the Soviet Union was excluded, the program exacerbated ongoing U.S.-Soviet differences over the price of U.S. grain by lowering the price of wheat to many importers but not to the Soviet Union. Despite the 1983 LTA to purchase a minimum of 4 mmt of U.S. wheat annually for 5 years, the Soviets bought significantly less wheat from the United States — 2.9 mmt in 1985 and .15 mmt in 1986. To encourage the Soviet Union to purchase the minimum quantities of U.S. grain specified in the agreements, USDA offered wheat to the Soviet Union under EEP on August 1, 1986. The offer to the Soviets did not provide for a sufficient subsidy to make U.S. wheat prices competitive, and the offer expired on September 30, 1986, without the Soviets purchasing any U.S. grain; the Soviets did purchase wheat from the European Community during this time. The price differential was fundamentally resolved in April 1987 when USDA again targeted wheat sales to the Soviet Union under EEP and increased bonuses to enable U.S. exporters to sell wheat at competitive prices.

The Soviet Union has been the single largest participant in the Export Enhancement Program since the Soviets became eligible in 1987. As of June 18, 1991, the Soviets had purchased about 23.4 mmt of wheat and about 47,000 metric tons of wheat flour through the program.

A June 1990 GAO report concluded that the program appears to have been critical to making sales in the Soviet Union.<sup>4</sup> During periods of surplus supplies on the world market, the Soviet Union has taken advantage of competition among exporters to obtain the best possible price and terms. U.S. wheat sales and sales of other commodities sold under the program to the Soviet Union would likely not occur if the EEP did not help price U.S. exports competitively.

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<sup>4</sup>See International Trade: Export Enhancement Program's Recent Changes and Future Role (GAO/NSIAD-90-204, June 14, 1990).

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## Participation in the Export Credit Guarantee Program

On December 12, 1990, the Secretary of Agriculture announced that \$1 billion in export credit guarantees would be made available in connection with sales of U.S. agricultural commodities to the Soviet Union under USDA's Export Credit Guarantee Program (GSM-102) for fiscal year 1991.<sup>5</sup> This decision to grant the Soviet Union export credit guarantees was made during the Soviet Union's December 1990 food shortages. During the last months of 1990, the Soviets had sought to line up export credits to purchase needed commodities and food products from countries that traditionally exported agricultural commodities to the Soviet Union. The Soviets needed such credits because they had a limited amount of hard currency reserves available to purchase food and other items and to finance their ongoing trade deficit with nonsocialist countries. The U.S. response to the Soviet Union's request for assistance took place in the context of growing western efforts to help the Soviet Union. As of December 1990, France, Italy, Spain, Germany, and Canada had extended about \$3 billion in credits to the Soviet Union to finance agricultural purchases in the following months.

According to the USDA's January 1991 announcement, \$530 million was to be made available for sales of feed grains (barley, corn, sorghum, and oats); \$165 million for wheat and flour; \$130 million for protein meals (soybean meal, cottonseed meal, linseed meal, and sunflower seed meal); \$25 million for frozen and chilled poultry meat; and \$50 million to cover certain transportation costs. In February \$58 million was allocated for soybeans and \$9 million for almonds, and in March \$33 million was allocated for feed grains.

Over the last year there have been extensive discussions about the advisability of offering export credit guarantees to the Soviet Union in light of its human rights violations, its collapsing economy, and its deteriorating creditworthiness. Particularly problematic is whether the Soviet Union should be given food aid since its food shortage stems from distribution rather than supply problems. This issue has been a sensitive one involving balancing the U.S. agricultural sector desires, market development concerns, and financial and foreign policy interests.

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<sup>5</sup>The total amount of loan guarantee exposure is controlled through an annual allocation process in which guarantees for specific agricultural commodities and countries are allocated. Allocations are based on an individual country's agricultural needs, its market development potential for U.S. commodities, and the ability and likelihood that the country's financial sector (or government) will repay the guaranteed loans. An implicit consideration in the allocation process is whether other countries are also providing agricultural credits; the United States is motivated to allocate credit guarantees in order to maintain market share if credit guarantees are offered by other countries.

The U.S. share of Soviet imports has a significant impact on U.S. farm programs, government outlays and farm incomes. If the United States were to choose not to facilitate Soviet imports, it would incur additional domestic program costs and lose market share. Most countries that regularly sell grain to the Soviet Union provide them credits, and world grain markets are highly competitive. The Soviet Union's annual credit needs from the United States are forecasted to be at least \$2 billion-\$3 billion. If the Soviet Union is able to improve its agricultural production through instituting major economic reforms and lowering imports, it could become less of a significant factor as an importer but more of a factor as a significant grain trader.

It is difficult to deny the foreign policy aspects of offering the Soviet Union export credit guarantees. Title XV of the Food, Agriculture, Conservation, and Trade Act of 1990 (known as the 1990 Farm Bill) explicitly prohibits the Secretary of Agriculture from issuing export credit guarantees to any country that the Secretary determines cannot adequately service the debt associated with such a sale. The act also prohibits the issuance of export credit guarantees for foreign aid, foreign policy, or debt rescheduling purposes. According to a key congressional staff member, the intent of this legislation was to prevent a repetition of the situation in which creditworthiness considerations were minimized for foreign policy objectives in order to provide Iraq with GSM export credit guarantees. The U.S. taxpayer may be responsible for up to \$2 billion in outstanding guaranteed loans on which Iraq has stopped making payments.<sup>6</sup>

Prior to the administration's decision to grant the original \$1 billion in agricultural export credit guarantees, there was considerable discussion within USDA about the Soviet Union's creditworthiness and its ability to service the debt associated with the GSM-102 purchases. Furthermore, the National Advisory Council,<sup>7</sup> which typically meets before credit guarantees are approved, recommended approval of the \$1 billion in credit guarantees to the Soviet Union only after the decision on the issue

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<sup>6</sup>See International Trade: Iraq's Participation in U.S. Agricultural Export Programs (GAO/NSIAD-91-76, Nov. 14, 1990).

<sup>7</sup>The National Advisory Council is an interagency committee that provides advice and recommendations to government agencies, such as USDA, on international financing matters. Council membership consists of the Secretaries of the Treasury (who also serves as the chair), State, and Commerce; the U.S. Trade Representative; the Chairman of the Board of Governors of the Federal Reserve System; the President and Chairman of the Board of Directors of the U.S. Export-Import Bank; and the Director of the International Development Cooperation Agency. A staff committee comprised of economists and other agency professionals handles routine Council business.

had been publicly announced by the administration. The official USDA explanation for approving the credit guarantees in light of concerns about the Soviet Union's creditworthiness was the development of the Soviet market for U.S. agricultural goods.

In order to grant the guarantees, President Bush temporarily waived the freedom of emigration provisions contained in the Jackson-Vanik amendment (section 402) to the 1974 Trade Act, which bars access to official credit and credit guarantee programs to countries that restrict emigration. The Soviet Union's improving record on emigration liberalization provided justification for granting the waiver. However, shortly after the December 1990 announcement of the export credit guarantee package for the Soviet Union, the Soviet military used force to suppress independence movements in the Baltic republics of Lithuania and Latvia. The January 1991 military crackdowns have called into question the legitimacy of the Soviet Union's independence and democracy reforms and led to a reassessment by the administration and the Congress of bilateral relations with the Soviet Union. As a result, the course of future U.S.-Soviet relations has been carefully scrutinized by many in the government, the press, and the public, and further U.S. government credit packages, as well as other U.S. government initiatives, have been under review. The President is currently considering whether to extend most-favored-nation trade status to the Soviet Union.<sup>8</sup>

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## The Soviets' Request for Additional Export Credit Guarantees

In April, despite its uneasy relationship with the United States, the Soviet Union requested the extension of \$1.5 billion in GSM-102 export credit guarantees for 1991, in addition to the \$1 billion it had already received. On June 11, 1991, after great debate, President Bush announced his decision to meet the Soviet request for the additional agricultural credit guarantees. The loan guarantees are to be made available in three tranches over 9 months—\$600 million in June 1991; \$500 million in October 1991; and \$400 million in February 1992. USDA has already committed \$4.2 billion of the \$5 billion authorized in fiscal year 1991, which is why the bulk of the additional credits will not become available until fiscal year 1992. The \$1.6 billion in loan guarantees approved for the Soviet Union for fiscal year 1991 represents

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<sup>8</sup>Most-favored-nation trade status is a commitment that a country will extend to another country the lowest tariff rates it imposes on imports from any other country. When a country agrees to cut tariffs on a particular product imported from one country, the tariff reduction automatically applies to imports of the same product from all countries eligible for most-favored-nation treatment. All contracting parties undertake to apply such treatment to one another under article I of the General Agreement on Tariffs and Trade.

almost one-third of the total made available to all countries this year, an unprecedented single country share.

There have been extensive debates in both the House and Senate over whether to extend credits to the Soviet Union. The key issues under discussion have included (1) whether temporarily easing the food shortages will improve public opinion about President Gorbachev, thus preventing his demise and the ascendancy of a more repressive regime; (2) the recent crackdowns on the republics' independence and democracy movements; (3) the impact of extending credit guarantees on U.S. balance of trade and farm incomes; (4) U.S. market retention and expansion (France and Canada have recently announced agricultural credit offers to the Soviet Union); (5) Soviet eligibility for food aid; (6) the future of market reforms in the Soviet Union; and (7) the Soviet Union's deteriorating economy and its ability to repay future debt (i.e., the central government's control of natural resources as a means of generating hard currency and its current debt load).

A number of skeptics have raised concerns over the deterioration in the Soviet Union's creditworthiness. Over the past year, major international banks have drastically downgraded their ratings of the Soviet Union's ability to repay its external debt. The sharp drop-off in the Soviet Union's ratings has occurred more rapidly in 1 year than did similar ratings for any other country since 1983 except for Kuwait when it was occupied by Iraq. According to a joint analysis recently prepared by the CIA and the DIA,<sup>9</sup>

[T]o finance their burgeoning import bill, the Soviets nearly doubled their total borrowing from the West from 1987 to 1989. In late 1989 they also began to run up an unprecedented backlog of late payments to Western suppliers. With these arrears coming on top of mounting domestic political and economic turmoil, the Soviets found Western banks unwilling to provide new loans last year. To alleviate the resulting credit crunch, the USSR has drawn down cash reserves in Western banks, stepped up gold sales, and obtained financial assistance from Western governments. Nonetheless, its hard currency position remains weak.

The analysis also states that

[T]he Soviets will also face a rising debt service burden in the form of interest charges and scheduled payments of principal on medium- and long-term debt. Some short-term credits that Western lenders have been refusing to roll over also will

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<sup>9</sup>Beyond Perestroika: The Soviet Economy in Crisis.

have to be repaid, and the pressure to eliminate arrears in payments to Western firms will be great.

If, due to the Soviet Union's severe economic deterioration, the Secretary of Agriculture had determined that the Soviet Union could not adequately service the debt that would arise from receiving an additional \$1.5 billion in agricultural credit guarantees, no new credits could have been extended.<sup>10</sup> The foreign policy and foreign aid restrictions would also have prohibited extending additional credits to the Soviet Union if such credits could not be justified on a commercial basis, even if the President believed that such an extension would be in the national interest.

In order to provide more flexibility in granting export credit guarantees, amendments to the 1990 Farm Bill were proposed that would allow the President to provide agricultural credit guarantees when he believes they are in the national interest, irrespective of the foreign aid/foreign policy and creditworthiness restrictions. If the current legislation were to be amended to make credit guarantees available to high-risk countries irrespective of their ability to repay, the GSM 102/103 programs could return to the situation that existed before the enactment of the reforms in the Food, Agriculture, Conservation, and Trade Act of 1990: They would be more closely tied to foreign policy objectives. The use of the programs for this purpose will increase their cost to the taxpayer and thus allow export credit guarantees to be used as foreign assistance.<sup>11</sup> The benefits of the programs in terms of the development and retention of important U.S. markets, as well as the furtherance of U.S. foreign

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<sup>10</sup>The USDA's Foreign Agriculture Service's Trade and Economic Information Division prepares a credit risk analysis for each country to which USDA extends export credit guarantees. During the 1980s the division prepared country profiles that were mainly qualitative in nature, and the guarantee programs were influenced more by market development potential and foreign policy considerations than by credit risk concerns. In May 1990 the division adopted a new credit risk analysis procedure with greater emphasis on evaluating financial risk. Under the new procedure, analysts issue a preliminary rating for each country based on two consensus risk ratings of major international banks and the country's economic, political, and social history. They then adjust this rating using the most current information in these areas. Based upon these considerations, as well as the country's repayment history and ability to access foreign exchange, analysts recommend how much credit to allocate to each country. This proposal is forwarded to the National Advisory Council for review and recommendation.

<sup>11</sup>In our report titled Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs Are High (GAO/NSIAD-91-180, Apr. 19, 1991), we estimated that long-run costs of the programs will be about \$6.7 billion, or 60 percent of the \$11.2 billion in loan guarantees and accounts receivable outstanding as of May 1990. Furthermore, we projected costs will be even higher if the level of outstanding loans and guarantees continues to grow and the average risk of new guarantees is not substantially reduced.

policy objectives, may justify the added costs of such a change. However, this change would create the potential for costly initiatives such as occurred with Iraq.

In May 1991, after hearing testimony and debate, the Senate passed a nonbinding resolution (S. Res. 117) that recommended extending to the Soviet Union the \$1.5 billion in agricultural export credit guarantees. The resolution recommended providing the guarantees in three separate \$500-million tranches, with the release of the second and third tranches conditioned on satisfactory Soviet utilization of the preceding tranches and on compliance with all the assurances provided by the Soviet government. By dispensing the export credit guarantees in tranches, USDA would have some leverage over the Soviet Union's repayment efforts. If the Soviet Union did not remain current on the tranches it received, it would not be eligible to receive additional tranches. This procedure would help to minimize U.S. exposure to loan default.

Also in May 1991, the House withdrew its proposed amendments to the 1990 Farm Bill. According to a key congressional staff member, the House was of the opinion that the present legislation is flexible enough to justify whether or not the Soviet Union should be extended additional agricultural export credit guarantees. In June 1991 a bipartisan group of 36 House Agriculture Committee members cosigned a letter sent to the Secretary of Agriculture that sought to clarify the 1990 Farm Bill's provisions regarding a country's eligibility for export credit guarantees. Meanwhile, although the administration had not announced its decision about whether to provide the Soviet Union additional guarantees, the President extended the 6-month waiver on the Jackson-Vanik amendment for another year. The waiver, which was due to expire, is necessary for the Soviet Union to remain eligible for U.S. export credit guarantees.

According to USDA, the administration decided the legislation was broad enough to be able to make a determination about the Soviet Union's creditworthiness and to decide whether to offer it additional loan guarantees. Finally, on June 11, 1991, President Bush announced his decision to extend the additional \$1.5 billion in loan guarantees in three tranches. According to a White House press secretary, there are no conditions attached to the tranches—they are not being proffered to induce reforms of the agricultural distribution system. However, the Soviet government has made assurances that the grains will be fairly distributed among the Soviet republics and the Baltic states. A majority of the grain will be used as feed grain for cattle, sheep, agricultural uses, and

poultry production. It is unclear how much of the \$1.5 billion will be used to cover transportation costs.

According to the White House Press Secretary, the President's assessment of the Soviet Union's creditworthiness was based on the following: 1) the review of its credit record on past loans — it has never defaulted on an official loan involving the United States;<sup>12</sup> 2) its repayment history on several hundred million dollars in loans through the 1970s, primarily from the U.S. Export-Import Bank; 3) the judgment of the USDA team that visited the Soviet Union in May; 4) the subsequent review by the Secretary of Agriculture; 5) the administration's discussions with Soviet officials; and 6) the commitment of President Gorbachev to move toward a market economy. The Press Secretary said in a June press briefing that the President's decision reflects the administration's desire to promote a continued positive evolution in the U.S.-Soviet relationship, and it is hoped that this assistance will help stabilize the food situation in that country. It is interesting to note, however, that the National Advisory Council once again did not meet to make a recommendation on the issue until after the President had made his announcement.

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## Other Aspects of U.S.- Soviet Agricultural Trade

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### U.S. Government Efforts

There has been no major organized U.S. government effort since President Gorbachev took power to actively encourage U.S. agribusiness to do business in the Soviet Union involving products other than grains. However, the U.S. government has attempted to broaden or reassess the U.S.-Soviet agricultural trade relationship. A few new initiatives have been undertaken, and several activities continue to progress.

For example, on May 17, 1991, President Bush dispatched a team of U.S. agricultural experts to the Soviet Union to assess its food distribution system. The team, which was headed by the Under Secretary of Agriculture for International Affairs and Commodity Programs, was expected to explore, jointly with Soviet counterparts, all aspects of the food distribution problem and the food market situation. It also was to gather

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<sup>12</sup>Soviet companies, most of them still state-owned, have about \$400 million in overdue debts to American companies.

information on economic and political reform. This information was to be used in the continuing review of the Soviet Union's request for additional credit guarantees. There are concerns that giving aid in the form of credits could delay economic reform by providing a crutch for the present system. Analysts feel that the Soviet Union's food shortages stem from food distribution problems rather than from food supply problems. Therefore, the team's mission was to find ways to improve food availability to the Soviet people.

Upon its return, the team reported that the Soviet Union does indeed have an adequate food supply and a good production system and that its food shortages stem from food distribution problems and the lack of regional supply centers. In extending the additional loan guarantees, President Bush expressed to President Gorbachev his continued interest in collaborating on a long-term effort to improve the food distribution system in the Soviet Union, primarily through the introduction of market measures. The United States is prepared to send a team of government and private experts to assist the Soviets in this effort.

Other government activities include efforts by the Department of Agriculture's Office of International Cooperation and Development to promote scientific exchanges between the United States and various countries, including the Soviet Union. In addition, the Department's Foreign Agricultural Service has stationed agricultural attaches in the Soviet Union to provide analysis on agricultural information to the Department and to consult with U.S. firms seeking to do business in the Soviet Union. The Foreign Agricultural Service has identified the Soviet Union as one of three markets where providing additional marketing staff and budget resources is justified. In April 1990 USDA approved the establishment of a small secretariat within its Foreign Agricultural Service to help in the administration's efforts to encourage market-oriented activities in Eastern Europe and the Soviet Union. Among other things, the secretariat serves as a point of contact for private U.S. agricultural and agribusiness organizations and individuals interested in doing business in Eastern Europe and the Soviet Union. The secretariat's focus has been on Eastern Europe because of the perception that it represents better near-term market opportunities than does the Soviet Union.

Within the Commerce Department there is a U.S.-U.S.S.R. Working Group on Food Processing that was created specifically to promote the expansion of mutually beneficial trade in food-processing and packaging systems. Although the Commerce Department formed the working group in 1988, the first official joint meeting did not take place until December

1989, after which there were three more meetings: March 1990, June 1990, and November 1990. The fifth meeting has been postponed until fall 1991. During the November 1990 meeting a study of food processing—meat and poultry, milled grains, and fruits and vegetables—was undertaken. At the next meeting, the second part of the study—dairy and sugar beets—will begin.

In August 1989 the U.S. Special Assistant to the President for Agricultural Trade and Food Aid submitted his report on opportunities for increasing U.S.-Soviet agricultural trade and cooperation. The report was written in anticipation of an increasing U.S. interest in ways to expand agricultural trade with the Soviet Union. The report outlined both opportunities and obstacles. It made no specific recommendations; rather it focused on identifying options in both the private and public sectors. The report noted that while opportunities for expanding trade with the Soviet Union existed in many areas, agriculture, food, and related industries held particular promise. The report emphasized the seriousness of the situation the Soviets faced in food and agriculture. It noted that agricultural reforms undertaken had not yet brought about material changes and could not for some time, probably not for several years. The report concluded that the United States could gain much by increasing agricultural trade with the Soviet Union and by helping the Soviet agro-industrial sector to develop.

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### Private Sector Efforts

The U.S. private sector has also been moving to expand the U.S.-Soviet agricultural trade relationship, and there are a few efforts worth noting. In spring 1989 two food-processing trade associations joined together to form the Food Industries International Trade Council. The council's goal was to enhance commercial relations between U.S. food-processing companies and Soviet food enterprises. Before the council was established, a small mission of about 15 presidents of major food and food-processing equipment companies went to Moscow for exploratory talks in October 1988. These presidents felt they could not afford, from a competitive standpoint, to miss an opportunity to gain a trade foothold in the potentially vast Soviet marketplace. Although the mission was a wholly private sector initiative, the delegation carried letters from the former Secretary of Commerce endorsing the enterprise.

There have been several follow-up meetings to the October 1988 meeting. While progress has been made in advancing the objectives of the council, the members face a fundamental difference in Soviet and U.S. business views toward joint ventures. The Soviets would rather

participate in joint ventures to gain access to U.S. technology and production than spend hard currency. The U.S. member firms, on the other hand, would prefer to sell finished products directly to the Soviets rather than engage in joint ventures. Most of the U.S. member firms are small and do not have the same capability as large companies to absorb the potential losses of new joint ventures. At a June 1990 food conference held by the council for U.S. food company officials and Soviet government officials in Washington, D.C., U.S. business executives identified hard currency difficulties as the most significant obstacle to expansion of U.S.-Soviet food-processing trade. According to some of the U.S. executives who attended, unless the Soviet Union addresses the problem of the nonconvertible ruble so that companies are able to repatriate their profits, few U.S. companies, other than large firms with substantial capital, such as Pepsico and McDonald's, are likely to invest in the Soviet Union. Those two companies, which have ongoing projects in the Soviet Union, are looking toward the future convertibility of the ruble. Smaller firms with less capital are taking a "wait-and-see" approach.



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