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REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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Agriculture's Implementation Of GAO's Wheat Export Subsidy Recommendations And Related Matters

Agriculture has not made a systematic evaluation of the former Wheat Export Subsidy Program, as recommended by GAO in 1973. Agriculture's current policy precludes the payment of such subsidies and provides no adequate surplus disposal alternatives should U.S. wheat inventories increase. Agriculture officials foresee no major change in the wheat market in the near future and see no need to evaluate the former program or to prepare a standby program based on that evaluation.

To give the Congress information that should be considered in the development of an effective standby Wheat Export Subsidy Program, GAO reviewed (1) Agriculture audits and (2) studies made by Agriculture, the executive branch, and a private consultant.

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MARCH 3, 1976

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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 Agriculture's implementation of GAO's 1973 wheat export subsidy recommendations and related matters. Interim staff briefings were provided to interested Members of Congress. We testified before the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations on August 1, 1975, to provide a status report on progress to date. A separate followup report on agency actions to implement GAO recommendations relating to wheat sales management will be issued in the near future.

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 of this report to the Director, Office of Management and Budget; the Secretary of Agriculture; the Chairman, Economic Policy Board; and the Executive Director, Council on International Economic Policy.

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

CCC	Commodity Credit Corporation
EMS	Export Marketing Service
FAS	Foreign Agricultural Service
GAO	General Accounting Office

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

REVIEW OF AGRICULTURE'S IMPLEMENTATION OF GAO'S WHEAT EXPORT SUBSIDY RECOMMENDATIONS AND RELATED MATTERS
Department of Agriculture

D I G E S T

At the request of several Members of Congress, GAO reviewed the Department of Agriculture's actions to implement recommendations contained in GAO's report, "Russian Wheat Sales and Weaknesses in Agriculture's Management of Wheat Export Subsidy Program" (B-176943), issued July 9, 1973. This report concerns GAO recommendations on the former Wheat Export Subsidy Program and related matters. A separate report on executive branch actions to implement GAO recommendations on management of wheat sales will be issued soon.

The Wheat Export Subsidy Program was suspended in September 1972 because of changes in market conditions and in national agricultural policy. Agriculture's authority for reinstating such a program has not been suspended, however, and could be exercised administratively without consulting Congress, should market and policy changes dictate. (See ch. 1.)

GAO's 1973 report recommended that Agriculture:

--Complete a systematic evaluation of the former program.

--Review the legality of subsidy payments involving grain sales to exporters' foreign affiliates.

--If a program review determines subsidies are needed at a future date, insure that a reinstated program will be effective and efficient and provide for its periodic evaluation.

Subsequently, the Permanent Subcommittee on Investigation of the Senate Committee on Government Operations investigated the 1972 Russian sales and the management of the program and recommended that "before the

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reinstating of any subsidy system, the entire mechanism should be thoroughly reviewed so that it is responsive to the objective of making United States farm products competitive in the world market and not used for profit or speculative purposes."

Observation on market conditions

Uncertainty concerning the U.S. and world wheat supply-and-demand situation has existed since the historic Russian wheat purchases of 1972. World wheat market tight supplies over the past 3 years and reduced U.S. wheat stock levels have shown signs of improving in recent months. Agriculture is forecasting U.S. wheat carryover to increase significantly by July 1, 1976, but concern over drought conditions in the U.S. winter wheat region may reduce future production and carryover estimates for the following marketing year.

CONCLUSIONS

Agriculture initiated a variety of audits, selective studies, and advisory position papers concerning wheat export subsidies. Most of these efforts did not, nor were they intended to, constitute the formal, systematic evaluation recommended by GAO. (See chs. 2 and 3.)

Agriculture officials contend that (1) there is no need to systematically evaluate the former subsidy program nor to subsequently develop a new, standby program and (2) the tight wheat supply and high demand situation existing since the Russian sales of 1972 should continue, precluding resumption of a subsidy. Agriculture's current policy opposes export subsidies and contributes significantly to its reluctance to evaluate the former program and to develop a comprehensive standby program. (See pp. 7 to 9 and 42 to 43.)

Moreover, this policy provides no adequate policy alternatives for disposing of surplus wheat should

--foreign demand for U.S. wheat decrease or stagnate;

--production of major foreign wheat suppliers increase, making them more attractive alternative suppliers of wheat; and

--U.S. production of wheat increase producing high surplus levels similar to those existing before 1972.

Agriculture's Office of Audit made three limited-scope audits covering selected aspects of the former program. One audit, involving a review of past affiliate transactions, was directly related to a GAO recommendation; the other two were compliance reviews related to a former special short-term subsidy program. These audits resulted in:

--A report on December 15, 1972, that disclosed that $2.7 million in subsidy offers had been improperly made to exporters.

--A report on August 22, 1974, that disclosed that some exporters had improperly used tolerance and other provisions of the subsidy program under the special System I regulations to their advantage. Agriculture brought $8 million in claims, now being negotiated, against 9 exporters.

--A report issued in June 1975 that reviewed the legality of subsidy payments involving sales to foreign affiliates. Only two transactions between affiliates were found to be questionable. The report concluded that failure to include Agriculture's interpretation of bona fide sales in program regulations had resulted in confusion for wheat exporters. (See pp. 9 to 20.)

Although the audit of affiliates supported GAO's conclusions and recommendations, it encompassed a small number of export contracts and did not constitute the thorough audit envisioned by GAO. Agriculture officials oppose reopening the audit to include a larger sample of export contracts. They maintain that the former program's recordkeeping provisions and the ambiguity of former subsidy regulations would limit their ability to determine program abuses and misuses resulting from questionable affiliate transactions. (See pp. 15 to 17.)

Possible recoupment of subsidy payments

Current Federal investigations of U.S. grain inspection practices raise the question of recovering Federal subsidy payments on grain exports. In view of the several billion dollars paid by the Federal Government to exporters under these programs, the Justice Department, Agriculture, and GAO are exploring the possibility of recouping subsidies on exports involving fraudulent grain inspection practices. (See pp. 19 to 20.)

Program evaluation needs

In July 1974 the Foreign Agricultural Service drafted a standby export subsidy proposal which was, to some extent, responsive to GAO's 1973 recommendations. But no thorough program evaluation preceded its development and officials expressed little enthusiasm for formalizing the proposal. GAO emphasizes the need for a thorough, formal evaluation of the former program's effectiveness and efficiency because of the vicissitudes of grain supply and demand. In any crop year, market factors may result in wheat surpluses, requiring some form of a subsidy program. (See pp. 7 to 9 and 29 to 34.)

RECOMMENDATIONS

GAO recommends that the Secretary of Agriculture:

1. Conduct an evaluation of the former subsidy program's effectiveness and efficiency, determine conditions under which subsidies may be needed, and prepare a standby subsidy program.

2. Reopen and expand the Office of Audit's review of the legality of export subsidy payments involving sales to foreign affiliates before August 1971, to obtain additional information on the extent to which affiliate transactions resulted in abuse of the former program.

3. Adopt provisions to insure that exporters and their affiliates transact business at arm's length, should a new wheat export subsidy program be established. (See pp. 36 to 44.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

Congress may wish to reexamine the entire subject of agricultural export subsidies and to determine whether legislation should be considered as a means for insuring a more effective and efficient subsidy program, should one become necessary in the future. (See p. 44.)

Congress may also wish to review results of Agriculture's evaluation of the export subsidy program and Agriculture's proposed guidelines for any new program.

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CHAPTER 1

INTRODUCTION

WHEAT EXPORT SUBSIDY PROGRAM

The Wheat Export Subsidy Program was established in 1949 to help the United States meet its obligation to export wheat at prices set under the International Wheat Agreement. To stimulate U.S. exports, the gap between higher domestic and lower world wheat prices was bridged by a subsidy.

Although the program's primary objective was to keep U.S. wheat generally competitive in world markets, it was also designed to (a) avoid the disruption of world market prices, (b) fulfill U.S. international obligations, (c) aid the price support program by strengthening the domestic market price to producers, (d) reduce the quantity of wheat taken into Commodity Credit Corporation (CCC) stocks under its price support program, and (e) promote the orderly liquidation of CCC stocks.

The Commodity Credit Corporation is a wholly owned Government corporation within the Department of Agriculture whose charter authorizes it to enter into and carry out contracts necessary to its business, to remove or dispose of surplus commodities, and to export to or aid in the agricultural development of foreign markets.

--The Secretary of Agriculture, as Chairman of the Board of Directors and operating under the authority of the charter, determines the need for subsidies to promote the export of wheat.

--The Assistant Secretary of Agriculture for International Affairs and Commodity Programs, who is the President of CCC, is responsible for policy decisions on subsidy rates and export price levels.

--The Foreign Agricultural Service administers the export subsidy program. The Export Marketing Service had administered the program until December 1973, when it became part of the Foreign Agricultural Service. This change was made to improve "effectiveness in the foreign market promotion, sales, intelligence, and international organizations areas," necessitated by the short supply situation and the reduction of personnel resources.

Through September 22, 1972, when the subsidy program was suspended, CCC incurred about $4.3 billion in subsidy costs for the export of 10.5 billion bushels of wheat. The program was suspended to allow wheat prices to seek their own level after massive Russian purchases in the summer of 1972 caused domestic wheat prices to rise substantially above export prices.

PURPOSE OF GAO REVIEW

The unusually large and unanticipated Soviet wheat purchases in 1972--at extremely high subsidy rates--caused intense concern within the Government over grain sales to nonmarket economies and over the need for export subsidies.

As a result, we reviewed the administration of the Wheat Export Subsidy Program and issued a report on July 9, 1973, "Russian Wheat Sales and Weaknesses in Agriculture's Management of Wheat Export Subsidy Program" (B-176943). We found weaknesses in several program management areas, including the method of establishing subsidy rates, the administration of controls, and coordination of the program. Our report concluded that Agriculture had never completed a formal, systematic assessment of the program's effectiveness and efficiency in meeting its objectives.

Although the subsidy program was suspended in September 1972, we believed that a systematic evaluation was necessary to avoid repeating the suspended program's weaknesses and questionable costs should the need for a subsidy program arise in the future and recommended that the Secretary of Agriculture:

--Review the entire subsidy program and predicate its reinstatement (if indicated by significant changes in market conditions and national agricultural policy) on a meaningful justification for its existence.

--Review the legality of subsidy payments involving grain sales to exporters' foreign affiliates, especially registrations under System I (a special short-term subsidy program--see Glossary) and those recorded before August 1971.

--If a program review concludes that subsidies are needed,

a. determine the most effective and efficient way to use subsidies to compete in world markets;

b. provide for periodic evaluation of program effectiveness and efficiency;

c. document the basis and reasoning used in establishing daily subsidies;

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

e. 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; and

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

In the wake of these recommendations, the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations investigated the 1972 Russian sales and the management of the program and recommended that "before the reinstating of any subsidy system, the entire mechanism should be thoroughly reviewed so that it is responsive to the objective of making United States farm products competitive in the world market and not used for profit or speculative purposes." The Subcommittee also recommended that the Comptroller General submit to Congress an annual report on future agricultural commodity export subsidies reporting how much was spent and giving an evaluation as to whether it should be continued.

Sales of large quantities of grain to the Soviet Union in 1974 and 1975 were not subsidized. Agriculture's interest in reactivating the subsidy program emerged in April 1975 when the domestic wheat crop threatened to produce large surpluses; however, subsequent massive Soviet purchases reduced official concerns about the surplus and official interest in reactivating the subsidy program. Nevertheless, changes in market conditions and in national agricultural policy supportive of export subsidies could occur, thus requiring a new subsidy program in the foreseeable future. Recent increases in the world wheat supply support this possibility and may once again place the United States in a surplus position, as the world wheat market appears to be shifting from a seller's to a buyer's market. 1/ It should be noted that Agriculture's authority for reinstating a wheat export subsidy program has not been suspended and could be exercised administratively without consulting Congress.

1/While Agriculture is forecasting U.S. wheat carryover to increase from 327 million bushels as of July 1, 1975, to between 390 and 465 million bushels as of July 1, 1976, concern over increasing drought in the Great Plains winter wheat region may reduce future projected production and carryover estimates for the following marketing year (June 1, 1976, to May 31, 1977).

Because of the above situation and because of the concern by Members of Congress and others about weaknesses in the program's management before its deactivation in 1972, we reviewed Agriculture's implementation of our 1973 subsidy recommendations and related matters. Our current report examines agency actions since 1973 and provides information on a variety of subsidy audits and technical analyses generated by Agriculture and the Council on International Economic Policy. Some of that technical material is included in this report to provide Congress with information that should be considered in the development of an effective, and less crisis-oriented, standby wheat export subsidy program, should such a program become necessary.

We will be issuing a separate report on Agriculture's actions to implement recommendations in the 1973 report concerning related matters, such as management of grain sales to nonmarket economies and of its mandatory export reporting system.

AGRICULTURE'S PROPOSED ACTIONS ON OUR 1973 RECOMMENDATIONS

On October 4, 1973, Agriculture sent us a statement of proposed actions on our recommendations. (See app. I.) Agriculture agreed that a thorough review of the subsidy program should be conducted, before it would be reinstated, to insure that such a program would be necessary. The letter indicated that a review was in progress. Agriculture expressed an intention to strengthen its analytical staff to improve evaluation of export programs. It also commented that should a program review determine that an export subsidy is necessary, it would endeavor to establish an effective and efficient wheat export subsidy program which would provide for appropriate safeguards on subsidy amounts and for periodic evaluation.

Although Agriculture did not share our concern over the legality of affiliate transactions under the former program, it agreed to review sales between affiliates to determine whether such sales were bona fide.

SCOPE OF REVIEW

We examined Agriculture reports, studies, documents, and memos. Various Agriculture officials in Washington were contacted to further develop, confirm, or update our information. Studies by the Office of Management and Budget and by a private consultant commissioned by the executive branch were obtained, examined, and summarized in this report.

We reviewed and analyzed position papers, examining the discussions on the need for a subsidy program and proposals for structuring a new program, should circumstances warrant a resumption of subsidies.

CHAPTER 2

AGRICULTURE ACTIONS ON GAO RECOMMENDATIONS

AGENCY RESPONSIVENESS

No formal, systematic assessment of the effectiveness of the export subsidy program was ever made during its 23 years of operation. Although major weaknesses reported by GAO were sufficient to question the program's design and administration, Agriculture has yet to make a thorough evaluation of it and Foreign Agricultural Service (FAS) officials have not developed a timetable for making such an indepth analysis. This type of extensive internal review has not materialized because the tight supply market situation existing for the past 3 years has resulted in the continued suspension of export subsidies. This market condition, in turn, has contributed to the consensus within Agriculture that action on the future of export subsidies is not a priority issue. As a consequence, Agriculture's responsiveness to our recommendations has been limited in nature and scope.

Major reorganizations in Agriculture during the past 3 years may have also contributed to the limited, fragmented, and generally inadequate response to GAO's 1973 subsidy recommendations. Three years ago, the Export Marketing Service (EMS) was responsible for considering our findings and recommendations and for taking necessary corrective measures and the Inspector General was required to follow up with agency officials to insure expeditious, responsible replies and completion of promised corrective action. EMS was merged into FAS in December 1973 and the Office of Inspector General was split into the Office of Audit and the Office of Investigation in January 1974. The responsibilities mentioned above shifted to FAS and Office of Audit, respectively. A third recent change merged the Office of Planning and Evaluation--which was responsible to the Under Secretary for departmental program planning and evaluation--into the Office of Management and Finance under the Assistant Secretary for Administration.

Even though the Wheat Export Subsidy Program was suspended in 1972 following massive Russian grain purchases, the authority for reinstating a wheat export subsidy has not been suspended and could be exercised. Therefore, it is necessary and desirable to evaluate the past export subsidy program and the entire issue of export subsidies so that, should a subsidy program be reestablished in the future, policymakers and administrators will have the benefit of insights provided by a thorough review.

As recently as April 1975, the FAS General Sales Manager stated that future export subsidies may be needed, depending on world prices and production volumes, and that Agriculture planned to have a revised barter program ready. The Secretary of Agriculture has stated several times that Agriculture would reactivate export payments if they were needed to meet competition in world markets. There are indications, however, that he would prefer to allow the market system to run its course before resorting to the use of export subsidy payments. If market conditions predicate the use of subsidies, the resultant response may not only be untimely and crisis-oriented, but may also be made at the expense of American farmers, exporters, and consumers and of foreign buyers.

The need for export payment programs has been specifically addressed in a series of limited studies made by the FAS, EMS, Office of Planning and Evaluation, and by a private consultant commissioned by the Council on International Economic Policy. However, these are not indepth analyses from a theoretical and practical viewpoint. (See ch. 3.)

AGRICULTURE POLICY

Agriculture's current policy supports a market-oriented, full-production position, maximization of exports, minimization of Government involvement and opposes export subsidies to meet world market conditions. Agriculture maintains that the tight supply and high demand world wheat situation which has existed since the historic Russian purchases of 1972 represents a dramatic change in world market conditions that will not be reversed in the foreseeable future. Should a future short-term wheat surplus develop, Agriculture indicates it would rely on Federal crop loans to protect farmers from low prices, not on export subsidies. However, the Federal crop loans program does not provide a means for disposing of surplus commodities. The Public Law 480 Program represents a limited form of surplus disposal, but is not intended to and does not offer the comprehensive nondiscretionary commodity surplus disposal that the Wheat Export Subsidy Program provided.

Agriculture's policy provides no adequate policy alternatives for disposing of surplus wheat, in the event that (1) foreign demand for U.S. wheat decreases or stagnates,

(2) production of major foreign wheat suppliers increases, making them more attractive alternative suppliers, and/or (3) U.S. production of wheat continues to increase, resulting in high surplus levels similar to those existing before 1972.

For more than two decades preceding the Russian purchases in 1972, the United States continuously experienced strong wheat surpluses necessitating the payment of an export subsidy and the establishment of other federally funded programs. Agriculture policymakers tend to perceive the recurrence of such a surplus market as unlikely. Nevertheless, the wheat export subsidy was an integral part of U.S. agricultural policy for 23 years, and Agriculture's authority to pay the subsidy continues despite the absence of revised regulations. Great uncertainty also exists within the domestic and international agricultural community concerning future supply and demand situations.

Purchases by the Soviet Union represent the greatest increase in demand for U.S. wheat over the past 5 years. The Soviet Union's buying intentions greatly influence Agriculture's projections for continued strong foreign demand. Although the Soviets have committed themselves to buy a minimum of 6 million tons of U.S. wheat and corn annually over the next 5 years, doubt continues to exist over their buying intentions beyond this minimum because of their erratic grain production and the nature of their political system.

Grain exports have clearly become a key U.S. foreign economic policy issue in the wake of the 1972 Russian grain sales. The United States currently exports 60 percent of its wheat, 50 percent of its soybeans, 25 percent of its corn, and 40 percent of its cotton.

It seems appropriate that Agriculture's policy should provide greater flexibility and responsiveness to a variety of supply-and-demand situations. Its current policy is predicated on the assumptions that foreign demand for U.S. grain will continue to be high and to expand and that major foreign competitors and alternative sources of supply will continue to experience production problems. In view of the fact that domestic use of wheat has remained generally unchanged over the past 10 years, Agriculture's full-production policy is highly dependent on the export market. If either of the above assumptions proves to be incorrect, the United States will once again return to a strong surplus position.

Ironically, in the summer of 1972, Agriculture was extremely reluctant to modify its surplus policy, including the payment of export subsidies which existed for many years, and to shift to a policy oriented to a low surplus and high export demand. Although Agriculture did finally adopt a market-oriented policy and suspend payment of subsidies, it finds itself in 1975/1976 committed to that policy with the same degree of rigidity that it had in support of subsidies in the summer of 1972 when signs of changing market conditions arose. Its current policy does not adequately provide for the development of a market situation that would necessitate reconsidering export subsidies and preparing a standby wheat export subsidy program. Consequently, if Agriculture were to alter its policy to implement a subsidy program in the future, the program could become operational without the benefit of adequate preparation and consideration.

Until recently, Agriculture has agreed that a formal systematic evaluation of the past export subsidy program was necessary. As late as 1974 it reiterated a commitment to such an evaluation as a necessary prerequisite to the establishment of a standby program for future implementation. However, high-level Agriculture officials have emphasized that their commitment to evaluate the former program is no longer relevant in view of current supply and demand conditions and a policy of full agricultural production.

AGRICULTURE AUDITS

At EMS' request, Agriculture's Office of Audit has conducted three audits of selected aspects of the past subsidy program. One audit, involving a review of past affiliate transactions, was directly related to our past recommendation; the other two audits were compliance reviews of the former special System I subsidy program. The scope of the audits consisted of examining exporter records to determine compliance with specific provisions of program regulations.

No comprehensive program audit has ever been conducted of the Wheat Export Subsidy Program by the Office of Audit. (See glossary for definitions of compliance and program audits.) Between 10 and 16 percent of the Office of Audit audits are program audits; the remainder are primarily fiscal and compliance audits. Only a program audit, such as the one completed by the Office of Audit in July 1974 on the now defunct Barter Program, would constitute the type of thorough evaluation we envisioned.

System I subsidy

The first audit request by EMS on September 14, 1972, to the Office of Inspector General occurred before publication of our report. The audit's purpose was to examine exporter records to insure that their System I subsidy offers followed the requirements of EMS Announcements 73-39A, 73-42A, and 73-43A, which governed the types of offers that could be submitted to CCC for subsidy payments and how the offers should be reported. A summary of the audit findings showed that 19 exporters booked for subsidy with CCC a total of 282,047,694 bushels of wheat under System I, with a computed subsidy value of $128,679,887. The average subsidy rate was 46 cents a bushel. However, 5,689,631 bushels, with a computed subsidy value of $2,739,915, were overbooked because:

--Three exporters had not excluded export sales equivalent to the quantity of wheat they had purchased at net prices before 3:31 p.m., August 24, 1972, and which had not been exported by that time.

--One exporter's sales contracts had been determined ineligible for System I subsidy.

--Four exporters had computed System I bookings as of the date they submitted their offers and not as of August 24, 1972, as stipulated in EMS Announcement 73-39A.

--One exporter had used an incorrect unexecuted sales contract amount.

--One exporter had booked a sale with a tolerance contrary to EMS Announcement 73-39A.

As a result of these findings, EMS--with the concurrence of Agriculture's Office of General Counsel--sent letters to seven export companies. The acceptances by CCC of ineligible offers were withdrawn or amended. EMS stated that two companies that had already received payments on their overbookings were to refund $32,671.58 and $29,744.98 to CCC. These two amounts have since been collected.

Affiliate transactions

The second audit was requested on November 13, 1973. It was to examine more thoroughly the sales between affiliated companies that served as a basis for offers made under System I, to determine whether (1) affiliated companies were acting in their own behalf as independent buyers and sellers, (2) exports were actually made against the sale involved, and (3) payment was made by the buyer to the seller for exported wheat.

EMS also requested that a representative sample of sales contracts under Revision IV Wheat Export Subsidy Program (GR-345) be examined to determine whether sales between affiliated companies were bona fide for purposes of qualifying for the carrying-charge payment. The audit was partially responsive to our recommendation that Agriculture "review the legality of export subsidy payments involving sales to foreign affiliates, especially registrations under System I and those recorded before August 1971."

The Office of Audit report restates our position that regulations under the Wheat Export Subsidy Program were silent about whether certain affiliate export transactions are required to be bona fide.

At various times, Agriculture officials have attempted to focus on exporters' relationships with affiliates. Before October 30, 1967, a provision in the GR-345 program (Rev. III, sec. 1483.105 (g)) stated that:

> "The foreign buyer may be an affiliate of the U.S. exporter, in which case the sale registered for export payment must be a bona fide sales transaction in which the affiliate is acting in its own behalf as an independent buyer and not on behalf of the exporter. The foreign sale shall not be a 'wash sale' or any other type of inter-company transaction which does not result in an actual exportation of wheat against the specific sale on which the export payment rate was based."

Agriculture's Office of General Counsel interpreted the provisions in April 1967 and listed two types of transactions which would not be recognized as bona fide sales eligible for subsidy payments under the GR-345 program.

> "1. A foreign affiliate buys wheat from U.S. exporter in accordance with instructions from U.S. exporter and resales such wheat either on their own initiative or at the direction of the U.S. exporter; and

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"2. A U.S. exporter sells wheat to an affiliate abroad and later acts as its agent to resale the wheat and/or acts as agent for affiliate in sale of wheat and later sells the affiliate a quantity of wheat to meet the commitment of affiliate to the third party."

These interpretations were never adopted by Agriculture. As our report stated, most exporters opposed the inclusion of specific language dealing with affiliate transactions "on the grounds that it would preclude competitive trade practices, reduce the volume of wheat exports, and increase the amount of administrative work for both the trade and the Government." Thus, the trade urged the broadest possible interpretation, assuming that it was essential for maximum program effectiveness.

From October 30, 1967, to August 1, 1971, regulations (GR-345, Rev. IV, Oct. 30, 1967) which came into being relaxed the restrictions then effective. Exporters were not required

"to have a firm sale before making specific export offer to CCC [but only to submit] a Notice of Sale at the earliest possible date. Such Notice of Sale could represent a sale made before or after the offer to CCC. The subsidy payment rate would be determined on the date of such offer and CCC's acceptance."

Agriculture reaffirmed the April 1967 interpretation that certain types of affiliate transactions would not be considered bona fide. A paragraph was drafted in February 1971 to clarify bona fide affiliate transactions in the subsidy program. The April 1967 interpretation was reiterated, but never incorporated into subsidy regulations.

Although restrictions were relaxed, the Office of Audit believed that Agriculture would have "detected or have been alerted to certain questionable export transactions between affiliates" because of the detailed information and evidence required to be furnished on sales. Yet the Office indicated that "it is difficult to administratively determine whether an affiliate acted independently of the U.S. exporter in making a particular purchase and also whether the U.S. exporter later acted as agent on the same sale."

Agriculture contended in Revision IV, and later in Revision V, that as long as particular sales were identified for incremental payments or subsidies tied to specific export sales, then the sales must be bona fide. In our opinion, whether, in substance, the affiliate transaction was bona fide seemed insignificant to Agriculture; i.e., a subsidy payment was justified as long as an export sale was assigned to it.

From August 1, 1971, until the program was suspended, notices of sales were eliminated as a requirement under Revision V. But this revision created a secondary problem. Exporters were not only given a more flexible operating environment because of lenient requirements, they also operated under an Agriculture management information system that did not function because of lack of critical market data. Agriculture contended that detection and enforcement against non-bona-fide export sales was administratively difficult, and the management information void compounded the problem.

In the audit review of selected sales contracts under Revision IV (prior to Aug. 1971), the Office of Audit found several questionable transactions between an exporter and its affiliate involving wash-out sales (seller buys back his contract from purchaser), cancellations, resales, and other principal-agent dealings. Questionable certifications were submitted to CCC for carrying-charge subsidy purposes and the required changes in Notice of Sale information were not furnished to CCC. Certain documents relating to the transactions in question were not available from the exporter. The matter was turned over to the Office of Investigation on March 20, 1975, for further investigation. The latter's investigation was concluded, reviewed, and returned to the Office of Audit for additional investigation. On the other transactions reviewed, the Office of Audit found no evidence that they were other than bona fide.

In reviewing sales between affiliated companies that served as the basis for offers made under System I, the Office of Audit found questionable transactions between another exporter and its affiliate.

> "For example, [the affiliate] went long on wheat purchases from [the exporter] and later made resales under the GSM-4 Credit Program with [the exporter] interceding on their behalf to effect such resales. Also [the exporter] and [the affiliate] were involved in a wash-out (buy back) of a sale quantity that was used in arriving at [the exporter's] System I eligibility."

* * * *

"* * * although we found no exceptions other than as mentioned in the details of this report, we noted the possibility of other transactions between U.S. exporters and their affiliates which would be questionable under USDA's interpretation of a bona fide sale. For example, a couple of exporters mentioned that it is possible they may act as agent in the resale of wheat previously sold to an affiliate if such a request were made of them. They reasoned that such could be the case because of the U.S. exporters location and fact that their affiliates may be in a long wheat position. They stated this to be a normal trading pattern and they would execute the same type of transaction for a non-affiliate. Exporters also mentioned that once they make a sale of wheat to an affiliate then the affiliate is acting as the principal and acts independently on the resale of such wheat even though such resale may be effected through the U.S. exporter."

As a result of its audit work, the Office of Audit recommended to FAS that if the Wheat Export Subsidy Program is reestablished, regulations and/or appropriate exporter announcements should be definitive with regard to Agriculture positions on affiliate export transactions which are required to be bona fide. Also, the washout and resales of wheat involving an exporter and an affiliate should be analyzed (in coordination with Office of General Counsel) to determine their effect on the desired independent buyer-seller relationship as contemplated for bona fide sale, and whether such transactions resulted in undue financial advantage for the exporter.

In responding to these recommendations, FAS officials indicated that if the subsidy program was reestablished, their position would be influenced by the type of program established. They also claimed that if the agency "should require certain affiliate export transactions to be bona fide," the regulations and/or appropriate exporter announcements should provide for this.

Barter audit

In an unrelated audit, evidence concerning the questionable nature of some affiliate export transactions emerged in July 1974 in a report completed by the Office of Audit on the past Barter Export Program.

"It was noted that several of the large grain exporters export through their subsidiaries or affiliates to the ultimate foreign buyer or importer. The subsidiaries or affiliates acted as the 'intermediate principals' in such a transaction. Sales documentation at the contractor and exporter levels indicated that the barter differential [payment] was being passed on from the exporter to the subsidiary or affiliate. The question of whether the differential was reflected at the ultimate foreign buyer or importer level was not always determinable at the contractor or exporter level. Through discussions at the importer level, the difference between the exporter's price to the subsidiary or affiliate and to the ultimate buyer or importer was determined not to be a large margin * * *. [In such cases where affiliates or subsidiaries acted as intermediaries] importers considered themselves doing business with the U.S. export firm. Basic reason given for 'intermediate principals' was 'convenient for subsidiaries or affiliates to handle at foreign level'."

Although companies that were awarded barter premiums to export were not required to pass any (or a portion) of a Federal payment on to the foreign buyer, Agriculture officials who administered the program maintained that it was generally understood that the payment was to be passed on to the foreign buyer. They contended that, without such a transfer of the payment, the export sale could not have been successfully transacted. The Office of Audit report did not recommend (if the program is reinstated in the future) that affiliates and subsidiaries be required to pass on the barter premium nor did it recommend a detailed analysis of the role of affiliates and subsidiaries affecting agricultural commodities exported under the barter program.

GAO evaluation

Observations on affiliate transactions made by the Office of Audit's Barter review reinforce the need for Agriculture to (1) comprehensively analyze the role of affiliates in former export subsidy programs, (2) determine whether Federal payments were improperly made, and (3) develop clear and comprehensive guidelines for the conditions under which affiliates are eligible to participate in agricultural export subsidy programs.

The Office of Audit's audit of affiliate transactions was intended to be responsive to our 1973 recommendations which urged a review of the legality of export subsidy payments involving sales to foreign affiliates, especially registrations under System I and those recorded before August 1971.

However, the audit of affiliates--although supportive of our conclusions and recommendations--encompassed a small number of export contracts prior to August 1971 and, therefore, did not constitute the thorough audit we envisioned. Office of Audit officials explained that their sample of contracts prior to August 1971 covered all contract activity during May to July 1971 involving affiliate transactions having carrying charges. From an analysis of the 2-1/2-month period, the Office of Audit documented and reviewed transactions involving a representative sample of major wheat exporters.

The Office of Audit selected a 2-1/2-month period because it believed that such a period would be representative of exporter activity. It maintains that access to subsidy-related records beyond the 3-year record keeping requirement of the program would be difficult. Officials of the Office also indicated that they had some difficulty in gaining access to records within the 3-year time frame. Therefore, they were skeptical of any effort to conduct a more exhaustive review of exporter subsidy records dated before 1971. They insisted that such a review of records would be of marginal use in view of the (1) time that has elapsed since the subsidy program was suspended, (2) absence of any binding legal requirement to maintain records beyond 3 years, and (3) difficulty in determining whether affiliate transactions were being conducted at arm's length.

The Office of Audit was concerned over the 3-year mandatory record retention provision of the former subsidy program, but it did not initiate the affiliate audit until the late summer of 1974, 1 year after the release of our report. Its officials indicated that preexisting commitments of higher priority and limited available resources prohibited the Office from undertaking the audit at an earlier date.

In spite of the difficulty involved in reviewing affiliate transactions under the subsidy program before August 1971, the need to review such transactions in a more exhaustive manner continues. The considerable amount of Federal funds involved and the recognized fact that the questionable affiliate transactions occurred under the former program warrant a more thorough review. There is some potential for recouping subsidies paid to exporters who did not enter into affiliate transactions on an arm's length basis. Moreover, a review can generate a considerable amount of valuable information to assure that, if the subsidy is reinstated in the future, abuses and misuses of the program--through certain types of affiliate transactions--will be minimized and/or prevented. We believe it is essential that any type of future program, once established, clearly define acceptable affiliate transactions and thus prevent program abuses.

Our 1973 report clearly maintained that we did not oppose all affiliate export transactions consummated under the Wheat Export Subsidy Program but were concerned over potential program abuse and misuse as a result of certain types of questionable affiliate transactions. Comments by Agriculture's Office of General Counsel and Office of Audit support our concern.

Agriculture's response to this concern has been that (1) the subsidy program was designed to interfere as little as possible with normal commercial transactions, (2) no other country precludes transactions between affiliates of international grain corporations, and (3) if the United States does not permit its exporters to use the same competitive devices as their competitors, its exporters will be handicapped while foreign exporters will benefit proportionally.

Agriculture's response does not accurately describe the nature of international grain exporting. Approximately 41 companies sell U.S. wheat for export, including 9 Japanese companies on the West Coast, but 6 are principally responsible for U.S. wheat exports. All of these six companies have international corporate relationships, including affiliates and subsidiaries, and also export the wheat of U.S. competitors, such as Canada, Australia, and the European Community. The multinational nature of the grain trade suggests that companies that export from the United States are not operating solely as U.S. corporations. It also supports the contention that multinational organizations that export from a variety of national origins can use their elaborate affiliate relationships to maximize their market position and subsidy eligibility.

Moreover, U.S. major competitors--Australia, Argentina, Canada, and the European Community--in the international grain market exercise a greater degree of control over the export of grain than does the U.S. Government. The governments of Australia and Canada, for example, completely control the sale of wheat for export.

Tolerance irregularities

In December 1973, EMS requested the Office of Inspector General to complete a third audit on exporters that submitted offers to export to CCC under System I subsidies.

This audit was to develop information that would allow EMS to review exporter applications of quantity tolerances to their shipments that came to EMS' attention as a result of a regularly scheduled audit--conducted earlier in 1973 by the Office--of subsidy and increment payments at the Prairie Village Commodity Office.

The Office found that some of the larger exporters had used the tolerance provisions of the Wheat Export Program to claim overshipments at high subsidy rates and undershipments at lower subsidy rates. Other exporters maximized their subsidy claims by applying shipments to the higher subsidy rate registrations first; unfilled shipments were then applied to the lower subsidy registrations. The Kansas City auditors performing the audit were told by EMS personnel that all exporters used similar methods in applying shipments to their export offers.

In its report to EMS, issued in May 1974, the Office stated that

> "as reported in audit 391-118-K [the scheduled audit of the Prairie Village Commodity Office], certain wheat exporters used the tolerance provisions of the Wheat Export Program to claim overshipments at high subsidy rates and undershipments at lower subsidy rates. By applying up to a 5 percent overshipment tolerance to registrations at higher subsidy rates under System I of Announcement 73-39A and undershipments down to 5 percent on lower subsidy registrations prior to System I, certain exporters were able to increase their subsidy payments. The GSMO [General Sales Manager's Office] * * * tentatively estimated that exporters, by using tolerance provisions, increased their subsidy payments by * * * $1.35 million."

The report's "Summary of Findings" disclosed a number of irregularities, including (1) questionable booking practices, (2) changes in sales contract data, (3) nonshipment of grain involving cancellations of contract amounts, washouts (see glossary), and circle, or string, settlement (i.e., seller was one party in a string of purchases and sales involving wheat and settlement was made by the seller without shipping the wheat), (4) evidence necessitating analysis of certain affiliate transactions, and (5) trading of subsidies between exporters.

As a result of these findings, the FAS Acting General Sales Manager, with the concurrence of the Office of General Counsel, sent the nine exporters letters stating tentative claims against them totaling approximately $8 million and ranging in amounts from $586.05 to $3,191,128.23. CCC had originally paid these amounts to the exporters, but after the audit was completed it started to withhold subsidy payments on later sales from the exporters involved. However, the subsidy program was suspended before the total amount could be withheld. These tentative claims have been contested by the exporters, and final settlement depends on the outcome of private negotiations between Agriculture and the exporters and/or formal litigation. Negotiations have been continuing for more than 1-1/2 years, with settlement depending on the resolution of a difference in interpretation of the regulations by Agriculture and the exporters.

GAO evaluation

Agriculture is continuing to pursue its claim of tolerance irregularities against nine exporters for close to $8 million. We recognize the complexity and sensitivity of the situation but believe that Agriculture should expedite whatever formal or informal proceedings are necessary to settle the dispute. This should be done because of the significant amount of time already elapsed since the dispute began, the inconvenience to the exporting firms involved, and the need to recoup whatever amounts may be owed the U.S. Government.

POSSIBLE RECOUPMENT OF FEDERAL PAYMENTS DUE TO FRAUDULENT EXPORT INSPECTIONS

Although the primary thrust of this report is to follow up on subsidy recommendations made in our 1973 report, other related matters have emerged since its issuance, necessitating serious consideration.

Recent indictments by a Federal Grand Jury in New Orleans have centered on ineffective export grain inspection procedures. These indictments resulted from investigations into inspections of the quantity and quality of grain exported. The investigations have developed evidence of fraudulent practices and have supported an indictment of a major grain exporting company on conspiracy to commit systematic thefts of grain.

These investigations raise the question of the possibility of recovering Federal payments on grain exports, including export subsidies on commercial and concessional sales and barter payments. Agriculture no longer makes export subsidy payments, but it did as recently as September 1972. If evidence has been or can be developed which relates falsified inspections to export shipments, it is possible to trace the Federal payments made on those shipments through records of Agriculture and other agencies and to establish a basis for a recovery claim.

We asked whether Agriculture or Justice had included this possibility of recovering Federal payments in their current investigations of grain inspection procedures or whether they planned to include it in future reviews. The U.S. attorney in New Orleans has expressed an interest in pursuing cases of civil fraud and has expressed his hope that GAO and Agriculture would make the necessary audits. In view of the several billion dollars paid under subsidy programs, the Justice Department and GAO are exploring the possibility of recouping Federal subsidies on exports involved in fraudulent grain inspection practices. Agriculture established a task force in mid-November 1975, composed of representatives from its Office of Audit, Office of Investigation, and Office of General Counsel, to determine whether any Government export payments have been improperly made.

CHAPTER 3

STUDIES OF EXPORT SUBSIDIES

Agriculture's statement of intentions on our July 1973 recommendations reiterated the Secretary's position that the former program should be thoroughly reviewed and the need for subsidies formally established, before the program is reactivated.

FAS officially withdrew the subsidy regulations from the Code of Federal Regulations in April 1974. In a statement in the Federal Register, Agriculture commented that:

> "The Department is making an evaluation of the need for a wheat export program in the future, and generally, the method of operating such a program. Results of the study so far show that certain changes would need to be made in the detailed operating regulations if a program is reinstated. It is the Department's view that to continue having the regulations appear in the Code of Federal Regulations is inadvisable and may lead the general public to believe that if the program is reinstated, the regulations now appearing in the Code of Federal Regulations would apply."

As of January 1976, Agriculture had not submitted any revised subsidy regulations for inclusion in the Federal Register. Only limited action has been taken at Agriculture's policymaking level to evaluate the need for or the nature of a subsidy program should it be determined that a need does exist. This lack of substantive action appears to stem in part from the lack of need for subsidies due to the tight wheat supply situation over the past few years and from executive branch agricultural policy since the 1972 Russian sales, which is supportive of the free market, precluding the payment of subsidies for wheat and grain exports.

Our analysis of Agriculture actions on our recommendations included a review of studies which were prepared before and after the issuance of our 1973 report but which did not become available until after it was issued. Agriculture's Office of Planning and Evaluation prepared two of these studies, FAS and EMS prepared one each, and a consulting economist prepared two.

The timing and source of the studies suggest that only those by FAS and EMS were efforts to implement our recommendations. None of them can be considered as thorough program evaluations as defined in our glossary.

The studies outlined and measured different export payment proposals in terms of achieving stated objectives. Various proposals were then compared to assess the need for a program as well as to determine the most effective and efficient way to use subsidies. Also, the results of a survey of farm and trade groups were made available for our analysis.

The studies concluded that the need for a wheat export subsidy program was justified only when the domestic price was at or near a predetermined trigger price--the price at which Agriculture activates the mechanism for subsidy payments. They recommended an export payment program based on competitive bids as opposed to the program in operation in 1972, whereby the subsidy rate was established daily by Agriculture based on the difference between its established export target price and the domestic sales price.

OFFICE OF PLANNING AND EVALUATION STUDIES

"A Market-Oriented Exports Payments Policy for Wheat," dated October 31, 1972, states that export subsidies were introduced to enable exporters to compete in world markets for a particular commodity. However, there is some question as to whether the use of export payments was justified when (1) U.S. farm prices were more than domestic support prices, (2) world trade was conducted in a monopolist environment, and (3) Agriculture did not possess adequate information on which to base its pricing decisions. The study concluded, in part, that:

> "(a) wheat export subsidies are most effective in promoting exports when U.S. market prices are near the loan rate; (b) as prices drift upward, consideration should be given to reduce, rather than increase, export payments on wheat, as has been done in recent years; and (c) changes in the subsidy should be made only when significant signals about the supply and demand situation dictate."

In closing, the study suggested some other factors for consideration before a final decision on subsidy policy was made, including:

> "Registration procedures that would relate export payments more directly to the prices at which U.S. exporters buy and sell their wheat. This would reduce opportunities for windfall profits and make the subsidy more cost-effective.

"Market information that is consistent with the frequency of subsidy changes."

In reviewing the paper in November 1972, the former General Sales Manager of EMS observed that "the choice between this proposal and the existing [now suspended subsidy] program appears to be a trade-off between objectives." He stated that the former subsidy program could be better modified to meet the EMS goal of maximizing commercial exports, but he considered the market-oriented approach equally as workable over a period of time.

In additional written comments, the General Sales Manager cited as important advantages of the market-oriented export payments policy that it would relate subsidy expenditures more closely to price support objectives, be simple to operate, probably reduce export payments, and allow needed fluctuation in U.S. export prices.

Two disadvantages noted were that exporting nations would gain an important competitive advantage when the trigger price became apparent and that the proposal could be troublesome the first year and politically difficult to keep in force. These comments assumed that "an offer to export basis" feature would remain; the subsidy rate would be announced weekly, but subject to change any time; the trigger price would be set much higher than the loan rate to encourage the farmer to sell his wheat in the open market rather than to default and cycle the wheat through CCC; and a separate subsidy for each class of wheat, applicable alike to all coasts of export, would be established.

"Wheat Export Payment Policy," dated January 9, 1973, stated that, except for short periods, no export subsidy payments would have been required for fiscal years 1971 and 1972 if subsidy policy had allowed payments only when the U.S. market price was well above the loan rate, as this policy would have raised world prices and generated production response by competing countries, resulting in a 5 cent a bushel increase in the net export price.

CONSULTING ECONOMIST STUDIES

"Summary of Options for a Wheat Export Price and Subsidy Policy," dated November 8, 1972, prepared by D. Gale Johnson, an agricultural economist at the University of Chicago for the Director of the President's Council on International Economic Policy, listed six major options for deciding the objectives of a wheat export price and subsidy policy.

1. A subsidy designed to maintain export prices of U.S. wheat within a narrow range, with the subsidy equal to the difference between the export price and the domestic market price.

2. A subsidy designed to make U.S. wheat competitive at the going export price, with the subsidy equal to the difference between domestic and export prices, with the primary objective of achieving some absolute or relative level of U.S. wheat exports.

3. A fixed rate of subsidy established for a crop year or other period of time, with the rate (of subsidy) set to achieve a given absolute or relative level of U.S. wheat exports.

4. A "reactive" subsidy policy, with subsidies being paid in response to losses in particular markets or for relatively brief periods of time as a reaction to subsidies or export pricing policies of other governments; no specific total export quantity objective, with primary reliance upon market mechanisms to determine the level of commercial exports.

5. A price policy that uses export subsidies only when the U.S. farm price of wheat is, or is expected to go, below the price support level.

6. A price policy that depends entirely upon the market, and no export subsidies would be available.

The paper identified the important criteria to consider in evaluating these policy options and to assess their effects as to (1) Treasury costs, (2) farm incomes, (3) consumer costs, (4) quantity and value of wheat exports, (5) functioning of the market as a guide for production decisions, and (6) feeding of wheat to livestock compared with feeding of other grains.

The author assumed that the export market ranged from a stable to a strong market and that subsidies were highest for option 1, declining to zero for option 6, with equal subsidies under options 2 and 3. Based on these assumptions, he then evaluated each option in terms of its effects on the criteria, as reproduced in the following table.

Policy option	Treasury cost (short run)	Farm income	Consumer cost	Wheat export quantity and price	Feeding of wheat	Functioning of market
1	Large	Increase significantly	Increase significantly	Increase quantity, decrease price	Reduce significantly	Very unfavorable
2	Medium	Increase	Increase	Uncertain, probably little effect	Reduce	Quite unfavorable
3	Medium	Increase	Increase	Uncertain, probably little effect	Reduce	Quite unfavorable
4	Small	Small increase	Small increase	Little or no effect	Little adverse effect	Moderately adverse
5	Small or nil	Little or no increase	Little or no increase	Little or no effect	Nearly maximum feeding	Little or no effect
6	None	None	None	No effect	Maximize economic feeding	No adverse effect

Considering Agriculture's repeatedly stated objective of maintaining an export policy that functions through the use of normal market mechanisms, the options available for consideration are reduced to numbers 5 and 6. These two options also have little or no effect on export quantities, which is desirable, considering the uncertain level of supplies available for export. Moreover, they have little or no effect on Treasury or consumer costs, also a desirable quality in view of Agriculture's aversion to subsidies in principle and congressional intent to maintain stable domestic prices and minimize subsidies.

It would seem irrelevant to consider the effects of these two options on farm income, as both U.S. exports and farm incomes are up and are expected to remain so, due to increased world demand for excess quantities of U.S. grain.

"Wheat Export Subsidies," dated April 26, 1973, contained the results of a survey on such subsidies. Officials from more than 20 organizations, including farm groups and grain exporters, were asked to respond to a series of questions on wheat subsidies. Only one respondent (a major farm organization) was opposed to export subsidies in principle but stated that, if the domestic price-support level interfered with wheat exports, a competitive bid system should then be used to set export subsidy rates.

Other respondents generally favored an export subsidy, mentioning the need to make U.S. wheat competitive against foreign governments' sales agencies, the need of U.S. producers to keep some advantages of supply management rather than transferring them to foreign producers, and the need to increase farm income.

Various concerned groups were surveyed on what they felt would be an appropriate subsidy program; the general consensus was that the program should not be operated as in the past, when Agriculture paid large subsidies despite a strong export market. A majority of respondents favored continuation of "an offer to export basis" procedure (in effect since 1967) in order to maintain exporting flexibility, but with significant modification such as:

--Combining the "offer to export" approach with a fixed rate for a definite period of time (a month or more), during which Agriculture would not maintain an export price objective (target price policy).

--Setting an export price objective for a specified period, such as a month, with possible changes at the period's end.

--Maintaining an export price objective, qualifying the objective by indicating a maximum subsidy rate for 3 months or more.

There was limited support for the general use of a bid-based subsidy rate, and little support for a "reactive" export subsidy designed to meet conditions in particular markets or for relatively brief periods of time, implying that export subsidies should be used only occasionally in response to particular circumstances.

A memorandum on this report, dated May 31, 1973, presented the Council of Economic Advisers' position on a wheat export subsidy and supported the economist's viewpoint that wheat export subsidies are a desirable or justifiable policy instrument only in unusual circumstances; i.e., much larger world wheat supplies, which could lower world market prices sufficiently to create the need for export subsidies. The memorandum stated such a prospect seemed unlikely in the near future.

EMS STUDY

"Alternative Export Payment Programs," issued on July 24, 1973, ranked the following programs.

1. No export payments.

2. Registered sales program.

3. Existing program, except that loan rate triggers payment.

4. Existing program with target price included.

5. Existing program with target price excluded.

This ranking was in terms of achievement when the stated objectives of a subsidy program are to maximize exports and incur the least risk for exporters; minimize export payments, administrative costs/problems, and administrative judgment in setting rates; improve farm prices, hold down world prices, and be compatible with price supports; meet criticism on payments to exporters, subsidy booking, and lack of sales volume information; get public acceptance of payments; and prevent cycling of grain through CCC.

EMS did not explain how the objectives were developed or rated in terms of achievability. Assuming that they were assigned equal weight, we computed overall rankings for each alternative and found that "no export payments" ranked above the other four alternatives involving payments in terms of achieving the possible objectives. The alternative "existing program, except that loan rate triggers payment" ranked above the other three. Under the existing program, an exporter may submit an offer to export a stated quantity of a certain class of wheat from a designated coast of export during a specified export period. Upon acceptance of his offer, the exporter is obliged to export in accord with the regulation to obtain payment. This program was developed to meet competition of wheat boards in other countries, which make sales for delivery some months in the future. The loan rate trigger payment program would use the export payment only to keep farm prices from going below the farm loan rate. A trigger price slightly above the loan would be set at some point, such as Kansas City and for Hard Red Winter wheat. Whenever the domestic price dropped below the trigger price, export payments equal to the difference between the two prices would go into effect. When domestic prices drifted upward, the export payment rate would be reduced. The trigger price modification would be consistent with the price support program, which sets the loan rate for wheat at the world price.

For the four alternative payment programs, the export payment represented the difference between a lower price and the domestic price so as to keep U.S. wheat competitive in world markets, with subsidies paid to exporters only after providing proof of export.

In addition to the five alternatives, two subsidy payment rate-setting procedures were ranked against each other--a bid procedure or an announcement procedure for any program for which export payments are made--in terms of achieving these same objectives.

Again, EMS did not explain how the objectives were determined or the weights to be assigned to each objective nor provide a summary analysis evaluating each alternative program in terms of achieving the overall objectives of export policy.

Using the tabular analysis for each objective included with the paper, we found that the "no export payments" policy was the worst alternative for improving farm income and preventing cycling of grain through CCC hands. It was the most effective, however, in minimizing export payments, administrative costs/problems, and judgment in setting rates and meeting criticism on bookings, and payments and public acceptance. Unlike the consulting economist's paper, consumer costs and market functioning were not included as criteria in assessing the effectiveness of export payments.

In January 1974, EMS proposed that research projects be undertaken on the effects of the Wheat Export Payment Program, adequacy of stocks of major commodities, financing of trade with nonmarket economies, and policy papers.

This proposal was submitted to the Chairman of the FAS Research and Intelligence Coordinating Committee. According to the FAS Acting General Sales Manager's comments to GAO in April 1975, one of these proposed research projects was accepted, for a study done by the Economic Research Service on "Adequate Stocks" in the light of the current world food problem. Agriculture has been slow to initiate studies in the other proposed research areas because of their low priority within the agency.

FAS STUDY AND SUBSIDY PROPOSAL

"Recommendations for Standby Export Payment Programs," dated July 26, 1974, acknowledged that subsidy programs had originally been intended to make price-supported commodities competitive in world markets, fulfill international obligations, reduce CCC surplus stocks under the price support program and promote their orderly liquidation, and aid price support programs by strengthening domestic market prices.

However, FAS stated that too much had been expected from these programs and that export payments had become an inappropriate tool for meeting all these objectives when the United States abruptly moved from a buyers' to a sellers' market in mid-1972. At that time, large sales of wheat to the Soviet Union at subsidized prices depleted nearly all the available domestic wheat surplus, contributing to a tight supply condition that has prevailed on the international wheat market for the past 3 years.

After reassessing its objectives, FAS indicated a limited export payment program is essential in market-oriented agriculture, as long as a stan- y price support program exists in the event of surplus production. In his cover memorandum to the position pap -, the Acting General Sales Manager of FAS stated that compared with previous wheat and rice programs, the proposed program would limit payment to situations where the domestic price is below a CCC loan-related price but above the world market price and to commercial exports. (The previous program had no such limits and it authorized payments on both commercial and title I, Public Law 480 exports.) Actual rates would be established by competitive bids received from exporters. (Under the previous system, CCC announced rates and the trade offered to export at those rates.)

He provided the following rationale.

"During periods of surplus production the loan rates * * * support the domestic market price for farmers. At this level however, exporters do not have sufficient flexibility on the down side to compete against foreign suppliers in foreign markets. It is at this point that an export payment becomes a necessary adjunct to the domestic program if commerical exports are to be maintained.

"If severe export losses are to be avoided an export payment capability should be maintained at a minimum on a standby basis. Export payments would come into play only when U.S. market prices approached the commodity loan rate and would be suspended automatically when U.S. market prices advanced to a level above the loan rate and price equilibrium is restored."

Bid method of setting subsidy rates

This paper also embodies the "bid" method of setting export payment rates, wherein

"CCC would invite offers from exporters [specifying] the quantity to be exported, a bi-monthly period for export and an export payment rate. CCC would accept, or reject, offers on the basis of the lowest rate(s) offered for each export period. To be considered for acceptance the rate could not exceed an amount by which the lower of the loan related price or market price is more than the competitive foreign price for comparable class, grade, etc. All rates and prices would be basis to U.S. seaboard position."

FAS supported its position on the bid method with these arguments. The method provides a realistic input into the rate-setting process, namely the trade's own evaluation of what is needed to export, and gives CCC better market information than did the system of announced rates. Bidding is preferable because it is incompatible with the practice of establishing net export prices or giving assurances to the trade that net export prices will be continued. Bid acceptances are announced after the fact, a critical time advantage in a buyers' market. If export payments are regarded as a tool to be used sparingly, such a program should phase in and phase out with a minimum impact on natural market forces. The bid procedure also gives CCC flexibility and control in fixing quantity because it can select bids that meet its price criteria and its quantitative objectives.

Comparison with barter program bid system

In our analysis of the bid proposal, we examined the bid system in the former barter export program to assess possible inherent flaws in a bid system. Other than specific administrative procedures and the nature of the programs, the barter bid system and the proposed system are similar.

The old barter export program was administered by EMS with the objectives of developing, maintaining, and expanding foreign markets for U.S. agricultural commodities and improving the U.S. balance-of-payments position.

A July 1974 Office of Audit report described the operation of the program.

"[From 1955 to 1962] CCC-owned agricultural commodities were exchanged under barter for strategic materials for stockpiling. The program has changed over the years as a result of the U.S. balance of payments position and pursuant to the 1962 Executive Stockpile Committee recommendations which were approved by the President. Procurements for the offshore programs of DOD [Department of Defense] and AID [Agency for International Development] have been emphasized since 1960.

"For a fee, [called a barter premium] private U.S. firms contract with CCC to either furnish funds directly to DOD or AID to procure needed foods and services or materials for delivery to DOD or AID. The private contractor also agrees to acquire and export a counter-value in eligible U.S. agricultural commodities to approved destination countries either from CCC-owned stocks or from private stocks * * *. [The contracts are awarded on a lowest bid basis.]

"The DOD and other agencies receiving the barter funds reimburse CCC, and CCC pays barter contractors for the F.O.B. value, including the barter-fee, of the commodities they export. It was anticipated that the barter fee paid to contractors would be used by them to marginally reduce the selling price of the commodities they export which would serve to place the commodities in a more competitive position."

The program was suspended in May 1973 because the high demand for U.S. agricultural commodities made it unnecessary; resumed for the month of June 1973; and has since been inactive.

Should the program be reestablished, the Office of Audit report recommended several improvements involving the program's bid system.

--Strengthen and improve the accomplishment of program objectives and the bid/award procedure.

--Strengthen the release of information procedures and channels.

--Strengthen and streamline contract administration.

--Improve the procedure for billing interest on contracts that specify "wheat included."

--Revise the barter contract terms for collection of interest, to eliminate possible unfair advantages that benefit certain types of contractors.

--Improve and strengthen overall contract compliance.

Large exporters had a competitive advantage in the barter bidding process because of their greater resources, worldwide connections, and ability to assume greater risks. The grain trade is still dominated by a few large multinational firms, which diminishes smaller exporters' prospects of being competitive in barter bidding. To illustrate, Agriculture awarded 409 barter contracts to 36 separate contractors in fiscal year 1972--65 percent of them to only 5 firms. High administrative costs and a minimum contract size of $100,000 also hampered smaller exporters. Agriculture must decide on priorities and objectives for the proposed bid system, i.e., should the goal of maximizing exports be met at the expense of less competition and lower program costs?

Management response

The FAS position paper on the Standby Export Payment Program was reviewed by the FAS Administrator. On July 26, 1974, he forwarded the proposal under cover of his memorandum of recommendations to the Assistant Secretary for International Affairs and Commodity Programs. In that memorandum, he endorsed the recommendations made for a standby export payment program as outlined in the position paper, adding that:

> "We estimate it will take at least six months before we can publish standby regulations in the Federal Register * * *.
>
> "If we postpone CCC Board [of Directors] consideration and the steps that must follow until prices decline to such levels [distress levels related to CCC loan rates], we will be denied the luxury of thoughtful deliberation and preparation of program regulations. Even in haste we would need three months to implement programs. Therefore, we recommend early consideration of these matters by the Board while these kinds of pressures are not upon us."

In a memorandum (prepared by the Assistant Sales Manager, Commercial Export Programs, FAS) of an FAS executive staff meeting held August 7, 1974, the Administrator stated that the Assistant Secretary was pleased with the proposals but had instructed him "to hold up on the implementation for a few months." At that time, the Assistant Secretary of Agriculture for International Affairs and Commodity Programs deferred action on the implementation of the proposal because (1) there was no perceived need for a subsidy program in the foreseeable future, (2) the national agricultural policy opposed export subsidies, and (3) FAS resources were concentrated on administering an export reporting system.

In our followup contacts with Agriculture officials in the spring of 1975, they commented that no action had been taken on the proposed program, because high-level Agriculture officials had imposed a standstill on the proposal, hoping it would not be needed. Career staff at Agriculture wanted to implement the proposal at that time, as it takes at least 6 months to get new regulations on the books, so that they would not have to react in a crisis atmosphere should the need for a subsidy program arise. The Assistant Secretary had not indicated agreement with the proposed program but with the concepts embodied in the proposal. When the proposal was submitted, Agriculture was more concerned with export controls than with an export payments program. A new awareness of the possible need for standby export incentives existed because of projections of higher levels of wheat carryover in 1975 despite large-scale purchases by the Soviets. FAS officials raised the topic of export payments early in 1975 in an effort to get the Assistant Secretary to approve the concept embodied in the position paper, so that work might be started to implement a new program.

GAO concerns

The FAS proposal for a revised subsidy program represents an improvement over the former program, but it has certain weaknesses. No detailed written guidelines exist as backup material; hence, it is unclear how Agriculture would implement such a proposal. In the absence of clarifying data on routine operation, it is impossible to determine whether the proposal--when translated into a functioning program--would be responsive to our past recommendations.

Administration of a bid system can be costly and complex. Large exporters traditionally have experienced a competitive advantage in a bid system because their greater resources enable them to underbid smaller exporters. Administrative costs and difficulty in qualifying for a minimum contract size (if one is established) also hamper smaller exporters' ability to compete successfully with large exporters when a bid process is employed. Consequently, it is imperative that Agriculture's bid system, if adopted, be administered so as to preserve competition in the market. Clear and concise regulations on the bid award process are essential to insure accountability. Agriculture should also endeavor to develop bid award procedures that (1) encourage broad participation by small exporters, (2) establish appropriate evaluation guidelines for the competitive bid process, (3) insure fair and equitable competitive bid procedures, and (4) establish a mechanism for compliance review at exporter and importer levels.

Ultimately, Agriculture must insure that its competitive bid system is designed to award bids no higher than necessary to export agricultural commodities.

OTHER STUDIES

The Office of Management and Budget issued a draft report in April 1975 entitled, "Interagency Report on U.S. Government Export Promotion Policies and Programs." The report examined various Federal agency efforts to promote U.S. exports in order to determine conditions requiring Government stimulation of exports, evaluate effectiveness and costs of export promotion programs in expanding exports beyond those which would have occurred without Federal action, identify changes to both existing and additional programs which would provide a more effective use of Government resources, and recommend policy decisions necessary to implement the changes.

The study did not comment on Agriculture's former export subsidy program. Initially the Office of Management and Budget had intended to evaluate the effectiveness of agricultural export subsidies as part of its overall evaluation of export promotion programs. However, after months of conflict with Agriculture officials concerning whether the subsidy program was eligible to be in the study, it decided not to include discussion of the subsidy program. The report explained that the programs were not designed primarily to assist export promotion objectives but to assist domestic agricultural objectives "of stabilizing, supporting and protecting farm income and prices; assisting in the maintenance of balanced and adequate supplies; and facilitating the orderly distribution of agricultural commodities."

Public Citizen (a nonprofit taxpaying organization supported by public subscription) petitioned the Secretary of Agriculture in August 1973 to amend regulations relating to subsidies for wheat exports. It was concerned that, under the old program, exporters could make windfall profits at the expense of the taxpayer by buying grain for export but not reporting it until the domestic price (and thus the subsidy) had risen. The Organization proposed tying "export payments as closely as possible to the exporters' costs to insure that the subsidy rate is adequate to encourage exports without being excessive." This could be done by requiring that Agriculture adjust the subsidy rate daily. Exporters would be required to submit offers for subsidy payments as soon as they acquired wheat under contract to export.

According to Public Citizen, Agriculture denied its petition on the grounds that the program was inactive. However, Agriculture did drop the regulations entirely in April 1974, after learning that the Organization was planning court action to effect changes in the regulations.

CHAPTER 4

CONCLUSIONS, AGENCY COMMENTS,

OUR EVALUATION, AND RECOMMENDATIONS

CONCLUSIONS

We evaluated several limited-scope audits prepared by Agriculture's Office of Audit and certain studies and advisory position papers prepared by Agriculture and others in an attempt to determine the Department's responsiveness to our 1973 report recommendations on wheat export subsidies. Significant portions of these recommendations had been only partially implemented, and we find such action inadequate considering the (1) $4.3 billion in Federal funds expended under the subsidy program before 1972, (2) significant weaknesses revealed by the 1973 report, (3) specificity of the recommendations, (4) potential for eventual reinstatement of an export subsidy program, and (5) recent disclosures of information on irregularities in the U.S. grain inspection system.

Systematic subsidy evaluation not made

Agriculture has not initiated a formal, systematic assessment of the effectiveness of the former subsidy program. It contends that recent tight supply and high demand market conditions obviate the need to seriously consider reinstating the program in the foreseeable future and that since the program is inactive there is no need for a thorough evaluation.

Despite the fact that the Secretary of Agriculture agreed on the need for such an evaluation in his letter of June 12, 1973, to the Comptroller General, the Department has not implemented our recommendation to review the past program and to establish a new standby program. The Secretary's reference to Memorandum 1777 as evidence of his commitment to program evaluation is, we believe, not responsive to our recommendation.

Secretary's Memorandum 1777, issued April 6, 1972, and relevant supplemental changes to that memorandum express the following position.

"The Department of Agriculture is committed to the objective of substantially improving the responsiveness, effectiveness, and efficiency of its programs in meeting national needs and goals. Systematic long-range planning and rigorous evaluation and analysis of existing and proposed programs, with the results reflected in annual budgets, is the key to meeting this objective."

Although this directive is evidence of Agriculture's concern for program evaluation, it does not insure that a comprehensive evaluation will be made.

Agriculture policy

Agriculture's current policy supports a market-oriented full-production position, maximization of exports, and minimization of Government involvement and opposes export subsidies to meet world market conditions. Should a future short-term wheat surplus develop, Agriculture indicates it would rely on Federal crop loans to protect farmers from low prices. However, the Federal crop loan program does not provide a means for disposing of surplus commodities. The Public Law 480 Program represents a limited form of surplus disposal, but is not intended to and does not offer the comprehensive nondiscretionary commodity surplus disposal that the Wheat Export Subsidy Program provided.

Agriculture's policy provides no adequate policy alternatives for disposing of surplus wheat, in the event (1) foreign demand for U.S. wheat decreases or stagnates, (2) production of major foreign wheat suppliers increases making them more attractive alternative suppliers of wheat, and/or (3) U.S. production of wheat continues to increase resulting in high surplus levels similar to those existing before 1972.

Limited audits of past program

Agriculture's Office of Audit has conducted three audits of selected aspects of the former subsidy program. One audit, involving a review of past affiliate transactions, was directly related to our recommendation; the other two were compliance reviews related to the former special System I subsidy program.

--A December 1972 report examined exporter records to determine whether subsidy offers had been properly made. It concluded that $2.7 million (2 percent of the sample) of the offerings had been overbooked with CCC. As a consequence, Agriculture withdrew or amended its subsidy offers to seven exporters. Two exporters had already received a total of $62,000 which was returned to the Government.

--An August 1974 report reviewed exporter applications of quantity tolerance to shipments made under special System I subsidy regulations of August 25 through September 1, 1972. The audit found that some exporters had improperly used the tolerance and other provisions of the subsidy program to their advantage. As a result, Agriculture brought tentative claims, which are currently being negotiated, against nine exporters for $8 million.

--A June 1975 report reviewed the legality of subsidy payments involving sales to foreign affiliates, especially under System I and those recorded before August 1971. The audit involved 85 percent of all System I contracts involving affiliates and a sample of contracts made prior to August 1971 involving affiliates and carrying charges. The export transactions reviewed were determined to be legitimate except for two instances of questionable transactions between affiliates, including resales, buy backs, washouts, and string sales. The report also concluded that failure to include Agriculture's interpretation of bona fide sales in program regulations, procedures, announcements, etc. can and has resulted in confusion by wheat exporters.

As a result of its findings, the Office of Audit recommended to FAS that an analysis of washout sales and resales of wheat noted in the audit be made to determine (1) their effect on the desired independent buyer-seller relationship as contemplated for a bona fide sale and (2) whether such transactions resulted in financial advantages for the companies involved. The Office also recommended that, if the program "is reestablished, regulations, and/or appropriate exporter announcements should be definitive with regard to any USDA position on affiliate export transactions which are required to be bona fide."

FAS officials responded that their position on bona fide affiliate export transactions would be influenced by the type of program established. FAS is considering an Office of Audit recommendation that it analyze, in coordination with Agriculture's General Counsel, questionable affiliate transactions involving one multinational company's washout sales and resales of wheat.

FAS officials maintain that affiliate transactions are normal trading practices of the export market that should not be subject to Government interference which could impede export flows. They also contend that monitoring and regulating such transactions is difficult and costly and would serve no useful purpose.

The audit of affiliates, although supportive of our conclusions and recommendations, encompassed only a small number of export contracts prior to August 1971 and did not constitute the thorough audit we envisioned. A more detailed audit is warranted because of the magnitude of Federal funds involved and the recognized fact that questionable affiliate transactions occurred under the previous program. We believe that, in the absence of a thorough audit, eligibility of certain types of affiliate transactions remains questionable.

Potential for recouping Federal funds

Although the primary thrust of our review was to follow up on our 1973 subsidy recommendations, other related matters have since emerged which require serious consideration.

The current Federal investigation of the U.S. grain inspection system--which has resulted in many criminal indictments for improperly grading, weighing, and handling grain in several port elevators--raises the question of recovering Federal subsidy payments on grain exports. Grain exported under subsidies--and virtually all U.S. wheat exported between 1949 and 1972 was subsidized--could have been affected by illegal inspection practices. In view of the several billion dollars paid under subsidy programs, the Justice Department and GAO are exploring the possibility of recouping Federal subsidies on exports involved in fraudulent grain inspection practices. The volume of federally funded grain exports and the dollar value of subsidy payments subjected to illegal grain inspection practice had not been determined as of December 1975. Agriculture has recently established a task force to investigate this situation.

Studies and analyses

Agriculture's Office of Planning and Evaluation, Foreign Agricultural Service, and Export Marketing Service, as well as a private consultant and a taxpayers' organization conducted limited analyses of selected aspects of the former subsidy program between October 1972 and July 1974. Their conclusions did not support the former program. Some of the more significant conclusions were that:

--Subsidies are most effective in promoting exports when U.S. market prices are near the loan rate and price support level and should be paid only when farm prices drop below these price levels.

--As commodity prices rise, export subsidies should be reduced.

--Changes in the export subsidy rate should be made only as the market situation dictates and then only when based on reliable export sales data.

--Future subsidies should be paid on a competitive bid basis and should be limited to commercial exports and not be made available for concessional exports.

--In the future, exporters should be required to submit offers for subsidy payments as soon as they acquire wheat committed to export.

Although these limited subsidy studies and their conclusions represent a form of responsiveness to our initial recommendation, there has been no systematic, formal evaluation of the former subsidy program's effectiveness and efficiency. In April 1974, Agriculture officially withdrew the former program's regulations from the Code of Federal Regulations, maintaining that, should subsidies be reinstated at some future date, those regulations would no longer be applicable. Agriculture, at that time, reiterated its commitment to completing a comprehensive evaluation of the subsidy program before formulating a new export subsidy program. However, the Secretary of Agriculture for International Affairs has since stated that the Department's interest in fulfilling that commitment is no longer operative because of its stronger commitment to a free market policy which precludes payment of export subsidies.

The need for Agriculture to evaluate the subsidy program is emphasized because market factors may, in any crop year, result in a wheat surplus, suggesting some form of a subsidy program. Current economic indicators reflect an easing of the recent tight supply situation and a return to more traditional levels of wheat surplus. Moreover, an Agriculture official commented that completion of a thorough program evaluation and development and adoption of a revised standby subsidy program involves approximately a year's effort. Although FAS drafted a standby export subsidy proposal in July 1974, no thorough program evaluation preceded its development. Policymaking officials expressed little enthusiasm for formalizing the proposal, developing new program regulations, and submitting them to the Federal Register for appropriate review and adoption.

FAS subsidy proposal

The FAS 1974 proposal for a revised subsidy program is, to some extent, responsive to our 1973 recommendations. Compared to the previous subsidy program, it would limit subsidy payments to situations where the domestic price was below a CCC loan retail price but above the world market price. Actual subsidy rates would be established by competitive bids received from exporters. Bids would include trade information on individual commodity positions, freight, financing and other relevant commercial data. This would assist the Government in keeping track of export quantities and destinations. Exporters could be required to name class of wheat and coastal range in their offers, and documentation of exportation. The bid procedure would give CCC flexibility and control in setting price and quantity objectives. Payments would be limited to commercial exports and would not include concession and title I, Public Law 480, exports. The risks associated with export trade would fall on the exporters, requiring them to price contracts at a level insuring themselves an adequate return.

The proposal represents an improvement over the former subsidy program, but it has certain weaknesses. It contains no detailed guidelines, so it is not clear how Agriculture would implement such a proposal. In the absence of clarifying data on routine operation, it is impossible to determine whether the proposal would result in an efficient and effective subsidy program.

Administration of a bid system can be costly and complex. Large exporters traditionally have experienced a competitive advantage in a bid system because their greater resources enable them to underbid smaller exporters. Administrative costs and difficulty in qualifying for a minimum contract size (if one is established) also hamper a smaller exporter's ability to compete successfully in a bid process. Consequently, it is imperative that a bid system, if adopted, be administered so as to preserve competition and have clear and concise regulations to insure accountability. Agriculture should also endeavor to develop bid award procedures that (1) encourage broad participation by small exporters, (2) provide for establishing appropriate evaluation guidelines for the competitive bid process, (3) insure that competitive bid procedures are fair and equitable, and (4) establish a mechanism for compliance review at exporter and importer levels.

Ultimately, Agriculture must insure that its competitive bid system is designed to award bids which are no higher than necessary to export agricultural commodities.

AGENCY COMMENTS AND OUR EVALUATION

The agency acknowledged the accuracy of the factual material presented in this report. However, it maintains that there is no need to systematically evaluate the effectiveness and efficiency of the former subsidy program and to develop a new standby program predicated on the results of that evaluation. The Assistant Secretary of Agriculture for International Affairs and Commodity Programs, in responding for the Department, stated that the tight wheat supply-and-demand situation that has existed since the Russian grain sales of 1972 should continue to exist, precluding the need to reestablish an export subsidy. He emphasized that Agriculture's market-oriented, full-production policy opposes the payment of export subsidies and that as long as that policy remains operational there will be no serious consideration of export subsidies in terms of an evaluation of the former program and the establishment of a revised standby program.

Agriculture officials reiterated their opposition to reconsidering the legality of certain types of affiliate export transactions under the former subsidy program to determine the extent of program misuse and abuse through such transactions. These officials contended that such a review would be of no benefit to the agency because of the ambiguity of former subsidy regulations on affiliates and the difficulty in determining abuses and misuses through certain types of affiliate transactions. They also maintained that, because exporters were only required to maintain records concerning their involvement in the subsidy program for 3 years, access to pertinent data would be difficult and the data would be incomplete. All these difficulties, according to agency officials, would make the prospect of recouping possible illegal subsidies paid to affiliates under the Wheat Export Subsidy Program extremely difficult, doubtful, and not cost beneficial.

Agriculture's original commitment to evaluate the former subsidy program has not been fulfilled. Although changes in the global wheat supply-and-demand situation have obviated the need for reestablishment of a subsidy program at this time, Agriculture's market-oriented policy does not provide a means for disposing of future surpluses. If Agriculture were to modify its policy due to changes in the market and reestablish a subsidy program, it would not have the benefit of the results of a thorough, systematic evaluation of the former program nor the availability of a well-thought-out standby program to implement, should a subsidy become necessary.

Although reopening the audit of questionable affiliate transactions under the subsidy program may not result in recouping subsidy payments, it will provide more extensive information on the misuse and abuse of the subsidy program, reveal such practices, and provide the comprehensive documentation necessary to develop future subsidy regulations which would preclude questionable affiliate transactions. Recoupment of subsidies paid to exporters for questionable affiliate transactions should not be ruled out in the absence of a thorough examination of contracts prior to August 1971. While difficulties exist in conducting such an audit, evidence revealed in the limited Office of Audit affiliate report of July 1975 clearly establishes the basis for a more extensive audit.

Office of Audit officials commented that, prior to this report, they had taken steps to increase their emphasis on "agency actions taken" in their system for following up on agency responsiveness to GAO report recommendations. These individuals indicated that although a limited followup system now exists, it has been primarily directed toward reviewing the agency's proposed actions.

We endorse the Office of Audit's changes in its system for following up on agency actions to implement our report recommendations. Such an effort, if institutionalized, would represent constructive actions and an improvement over the existing system, which does not provide for continuing periodic followup of agency action on our recommendations.

RECOMMENDATIONS

We recommend that the Secretary of Agriculture:

1. Direct the Office of Management and Finance and the Economic Research Service to (1) jointly conduct a thorough systematic evaluation of the former export subsidy program's effectiveness and efficiency, (2) study the entire issue of export subsidies and determine conditions under which subsidies are necessary, and (3) if subsidies are considered necessary under certain market conditions, establish guidelines for a revised standby subsidy program that provides for the most effective and efficient method of using subsidies in the world market and periodic evaluation of program effectiveness and efficiency.

2. Reopen and expand the Office of Audit's review of the legality of export subsidy payments involving sales to foreign affiliates, especially those recorded before August 1971, to include a significantly larger sample of exporters

and export contracts. The audit should provide additional information on the extent to which affiliate transactions resulted in abuse of the past subsidy program. As part of this audit, it is essential that auditors determine the amount of subsidy payments potentially affected and the likelihood for recouping subsidy funds expended under such circumstances.

The audit of affiliates could be incorporated into Agriculture's task force review of past export subsidy payments that resulted from the recently disclosed grain inspection fraud. The task force, in attempting to determine whether improper payment occurred and the possibility of recoupment of such funds, could provide a convenient and appropriate vehicle for examining the affiliate issue.

3. Should a new wheat export subsidy program be established, to insure that exporters and their affiliates transact business at arm's length and that accountability is present, regulations should provide for the following: (1) a comprehensive definition of a bona fide sale and affiliate sale, (2) a list of affiliates, their relationship to the parent company, and their functions, (3) clarification of an acceptable affiliate export transaction, (4) exporter certification that an agent-affiliate relationship does not exist with the buyer/end-user, (5) exporter certification that no preferential market relationship exists between the buyer and seller, and (6) periodic audits of affiliate transactions.

MATTERS FOR CONSIDERATION BY THE CONGRESS

In view of its continued interest in export subsidies and in view of Agriculture's inadequate response to past recommendations made by GAO and by the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations, Congress may wish to reexamine the entire subject of agricultural export subsidies and to determine whether legislation should be considered as a means for insuring a more effective and efficient subsidy program, should one become necessary in the future.

Congress may also wish to review the results of Agriculture's evaluation of the export subsidy program and Agriculture's proposed guidelines for any new program.

GLOSSARY OF TERMS

Barter fee	An incentive paid to U.S. firms to enter into barter contracts with CCC. The fee gives an incentive for entering into barter contracts in the form of more profit or allows contractors/exporters to sell their commodities at a lower price in the form of price discounts--by passing fee on to foreign buyer. The terms fee/differential/premiums/discounts are used interchangeably when referring to this incentive.
Carrying charges	Cost over a period of time of owning or "carrying" goods, including storage, financing, insurance, conditioning, etc.
C.I.F.	Cost, insurance, and freight: terms of sale which define buyers' and sellers' responsibilities with regard to physical delivery of goods and the expenses to be assumed by each party. Seller is obligated to deliver the goods to a water-borne conveyance for which he has contracted freight, to cover marine insurance, and to pay the premium for same.
Compliance audit	Audit to determine compliance with documented standards, such as laws, regulations, and contracts.
Concessional sales	Sales which allow the buyer payment terms more favorable than those obtainable on the open market. Under Public Law 480, the concession may be the type of currency accepted as payment, length of the credit and grace period, or interest rate charged.
F.O.B.	Free on board: a term of sale meaning that the seller agrees to deliver the merchandise aboard the carrier without extra charge to the buyer.
Hedge	The systematic attempt to reduce risk of loss from market fluctuations, by making a sale against a purchase, and vice versa.
Incremental subsidy	Additional subsidy provided for in Agriculture Announcements (sometimes referred to as carrying charges).

Loan rate

Short-term loans are available from CCC to farmers who participate by restricting acreage to their historical allotments less a required diversion to conservation use which varies from year to year. The price support loan rate specifies the dollar amount per bushel of expected production (given the acreage restrictions) that can be granted in the loan. The production itself is used as collateral so that if the market price rises above the loan rate, the farmer can sell the crop and pay off the loan with the proceeds. If the market price remains below the loan rate, the farmer has the option of defaulting on the loan and forfeiting his crop, in effect forcing the CCC to purchase his crop at the loan rate. This program acts as a price support mechanism by establishing a "floor" for the price. The Government in effect purchases commodities when market prices fall below loan rate levels and farmers choose to forfeit their crop collateral. If the CCC withholds those forfeited supplies from the market, the marketed supply is reduced in relationship to demand preventing further price declines.

Long position

A long position comprises purchase commitment(s), thus one may be long cash grain, long futures. A net long position represents the excess of purchase commitments over sales commitments. A party holding a long position is said to be a long. Long positions are taken in anticipation of an increase in market prices, and may apply to cash grain, futures, ocean freight, certain export subsidies, foreign exchange, and other elements of trading subject to price fluctuations and in which one may make an undertaking to purchase, in advance of selling.

Market-oriented policy

A policy in which Agriculture attempts to interfere as little as possible with the domestic and international agricultural market. It discourages subsidies for production and exports, letting market conditions be determined primarily by supply-and-demand factors.

Program evaluation	Formal systematic assessment of actual performance of programs in meeting goals of missions, achieving program objectives, and serving specified target groups. It is concerned with evaluating the effects and benefits flowing from program results and with their costs. It examines the extent to which program activities have concentrated on opportunities that have the most favorable benefit/cost ratios, or otherwise maximize the beneficial effects, in relation to cost. The selection of proper criteria for evaluating program effectiveness and efficiency in contributing to the achievement of missions and program objectives is the key to useful program evaluations. The goals of missions and program objectives, therefore, provide the basis for determining appropriate criteria.
Program audit	A comprehensive audit of a program or specific part of a program, function, or activity. It covers several or all of the implementing and operating level offices in the program and includes conclusions and recommendations.
Public Law 480	Enacted on July 10, 1954, it states that U.S. policy is "to expand international trade; to develop and expand export markets for U.S. agricultural commodities; to use the abundant agricultural productivity of the United States to combat hunger and malnutrition and to encourage economic development in the developing countries, with particular emphasis on assistance to those countries that are determined to improve their own agricultural production; and to promote in other ways the foreign policy of the United States." Law passed in an attempt to alleviate problem of U.S. agricultural surpluses compounded by the shortage of international purchasing power (dollars) in foreign nations needing U.S. agricultural products. Allows foreign nations to obtain U.S. commodities by means other than dollar purchases (see concessional sales and title I sales).
System I subsidy	Such subsidy was in effect from August 25 to September 1, 1972, with eligibility requirements spelled out in Agriculture Announcement 73-39A dated August 25, 1972.

Title I sales	Sales made under title I of Public Law 480, which includes local currency, dollar credit, and convertible local currency credit sales. It therefore includes all sales under Public Law 480 except barter sales. Before 1967 "title I" meant local currency sales, since only this type of sale was included under this title.
Tolerance	Percentage by which a specified contract quantity is permitted to vary.
Washout	Seller either buys back or settles specified contract with buyer without shipping wheat. Same as buy back.

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF THE INSPECTOR GENERAL
WASHINGTON, D.C. 20250

OCT 4 1973

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

Dear Mr. Staats:

Attached is the Department's statement of the actions taken on recommendations in GAO report B-176943, dated July 9, 1973, entitled "Russian Wheat Sales and Weaknesses in Agriculture's Management of Wheat Export Subsidy Program."

This statement was also furnished to the Senate and House Committees on Government Operations and to the Office of Management and Budget.

Sincerely,

Leonard H. Greess

LEONARD H. GREESS
Acting Inspector General

Attachment

GAO note: Portions of this attachme . pertaining to non-subsidy matters have been deleted and will be addressed in a subsequent report.

COPY

USDA STATEMENT OF ACTION TAKEN ON RECOMMENDATIONS IN GAO REPORT B-176943, DATED JULY 9, 1973, ENTITLED, "RUSSIAN WHEAT SALES AND WEAKNESSES IN AGRICULTURE'S MANAGEMENT OF WHEAT EXPORT SUBSIDY PROGRAM."

This statement relates to recommendations made by the Comptroller General which specifically concern the Department of Agriculture.

1. GAO Recommendations: Because of the weaknesses observed in the wheat export subsidy program:

"Review the program in its entirety and predicate its reinstatement on a meaningful justification of its existence."

As was stated in the letter dated June 12, 1973, from Secretary Butz commenting on the draft GAO report, 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 protect U.S. farmers from having to accept low world prices for a few commodities which depend heavily on exports and must meet subsidized export competition.

While we do not agree that the export payment program has suffered seriously from lack of periodic evaluation, we intend to improve this area. Secretary's Memorandum No. 1777 (Supplement 1) commits the Department to evaluate every one of its programs.

We also plan to strengthen our analytical staff as soon as budgetary limitations permit and therefore will be able to better analyze the export payment and other programs operated by EMS.

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

Failure to recognize transactions between affiliates under the program would seek to protect export payment expenditures at the expense of the program's effectiveness. Actually, the Department's purpose is served quite as well by a sale to an affiliate as to anyone else, as long as the wheat is exported. The export payment program is designed to interfere as little as possible with normal commercial practice. No other country rules out transactions between affiliates of international companies. If the U.S. does not permit exporters to utilize the same competitive devices as those of its competitors, U.S. exporters will be handicapped and other countries will benefit at our expense.

Under the System I announcement, exporters were permitted to register for the net difference between sales made and subsidy contracts entered into with CCC prior to 3:31 p.m., August 24, 1972. Certifications were required regarding the net differences and the sales which were used as a basis for establishing eligibility for System I subsidy contracts. Afterwards the Department performed an audit of each exporter who submitted such offers. This was done to determine whether or not the amount of subsidy registered was in accordance with the intent and purpose of the System I announcement. The audit did not reveal any evidence that the sales between affiliates which were used in establishing eligibility for subsidy under System I were not bona fide export sales.

Prior to August 1971, exporters were required to furnish a notice of sale giving certain terms of their export sales and designate a subsidy contract to which the notice of sale was to apply. A subsidy payment would not have been made on any export of wheat unless CCC had received a notice of sale covering such wheat. Exporters were also required to furnish evidence of sale to support their application for a carrying charge payment. Without a detailed review, it is our best estimate that carrying charge payments were made under at least 70 percent of the subsidy contracts. No doubt payments were made to exporters who had sold wheat to their affiliates. We know of no case where the exporter was unable to furnish acceptable documents.

Because GAO recommends that a review should be made of sales between affiliates, the Department will conduct an audit of a representative sample of the contracts upon which System I subsidies were based and contracts entered into before the notice of sale was eliminated to ascertain whether there is any evidence that the sales reported to CCC were not bona fide. However, our audit may be somewhat limited since the program regulations require only that an exporter maintain his records for a period of 3 years after the date of export.

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

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

Our reply to this recommendation must necessarily assume that the review of this program now in progress will recommend a program similar in concept to the one recently terminated. Otherwise, the details covered below may be irrelevant.

This recommendation will, of course, be the foremost objective of our review of the Export Payment Program.

"Provide for periodic evaluation of program effectiveness and efficiency, including periodic checks on affiliate relationships, users of wheat, and countries of ultimate destination."

While we do not agree that the Export Payment Program has suffered seriously from lack of periodical evaluation, we intend, as stated under 1 above, to improve this area. We disagree, however, that affiliate relationships of U.S. exporters are a valid program consideration since they cannot be singled out for separate treatment without discriminating against American-owned importers (as distinguished from foreign-owned importers) in the country of destination. Although we have considerable data and information as to users of wheat, and our present statistical summaries of wheat exports reflect countries of ultimate destination with considerable accuracy, we will continue our efforts to improve and refine this information where it is possible to do so.

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

We will endeavor to improve this area. However, again assuming the program concept is similar to the one recently terminated, an element of market judgment is essential.

"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."

We know of no practical way to establish an exporter's cost other than on a replacement basis at time and date of sale, the way the grain business is uniformly conducted both domestically and internationally. It is not ordinarily possible for an exporter to determine his precise purchase price for a particular lot of wheat later exported. Wheat is a fungible commodity stored on a commingled basis. With minor exceptions, such as West Coast White and durum wheat, inventories and commitments, both purchase and sale, are normally hedged. Accounting systems do not lend themselves to direct correlation between cost of purchase and proceeds of sale on any given lot of grain.

We can readily agree to the reconsideration of destination subsidies although this concept has been rejected on many occasions in the past. It has generally been evaluated as a short-run expedient significantly harmful to our long-term interests because of the disparities it contemplates in treatment of customers.

"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."

This is an established objective of the Export Marketing Service which is implemented to the best of its ability.

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

The carrying charge increment will be carefully considered in the course of the more comprehensive review of the Export Payment Program now in progress.

PRINCIPAL OFFICIALS

RESPONSIBLE FOR ADMINISTERING

ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF AGRICULTURE:		
Earl L. Butz	Dec. 1971	Present
DIRECTOR OF AGRICULTURAL ECONOMICS:		
Don A. Paarlberg	Mar. 1969	Present
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS AND COMMODITY PROGRAMS:		
Richard E. Bell	July 1975	Present
Clayton K. Yeutter	Mar. 1974	June 1975
Carroll G. Brunthaver	June 1972	Jan. 1974
Clarence D. Palmby	Jan. 1969	June 1972
ADMINISTRATOR, ECONOMIC RESEARCH SERVICE:		
Quentin M. West	Jan. 1972	Present
Melvin Upchurch	Sept. 1965	Jan. 1972
DIRECTOR, OFFICE OF MANAGEMENT AND FINANCE:		
Jerome A. Miles	Jan. 1972	Present
ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE:		
David L. Hume	Sept. 1973	Present
Raymond A. Ioanes	Apr. 1962	Sept. 1973
DIRECTOR, OFFICE OF AUDIT:		
Leonard H. Greess	Apr. 1974	Present