THE *Mysterious* POPULARITY OF EEP

by Robert L. Paarlberg

> Arguments in support of the U.S. Farm Export Enhancement Program (EEP) are numerous but not persuasive. The EEP does more to *displace* U.S. commercial exports than it does to build exports. It transfers more benefit to *foreigners* than to U.S. farmers. And instead of working against the European Community in GATT, EEP is mostly working to antagonize Australia and Canada—our natural allies against the EC in GATT. Political support for EEP is based on a widespread misperception that the program has played a major role in eliminating surplus stocks. This same misperception could someday make EEP politically unpopular, if stocks continue to fall and if markets become too tight.

This year's farm bill debate will almost certainly result in a continuation, into 1991-95, of the mysteriously popular Export Enhancement Program (EEP). Under this program, government owned commodities (CCC) are given away to exporters, so as to cheapen the cost to foreign customers of U.S. commercial sales. Since its inception in 1985, this export subsidy program has financed the movement of more than $2.6 billion worth of surplus commodities out of government storage and into export channels.

The popularity of the EEP is hard to deny, but on reflection, it is also hard to explain. Farm groups like EEP—even though it is a subsidy mostly to foreigners and to agribusiness. Foreigners and some in agribusiness, meanwhile, are among EEP's chief critics! Administration officials also like EEP—even though they were opposed to it at its inception, even though it weakens their moral authority in the current Uruguay Round of GATT negotiations, and even though it puts pressures on an already overstrained agricultural budget. For FY 1991, the Bush administration has actually requested an expansion of EEP budget authority, from $566 million to $900 million.

Although the program has been criticized for its careless administration, this has not prevented the interagency Trade Policy Review Group from deciding, last October, to *relax* several of the administrative requirements that were originally in place to discipline the EEP (including such things as the zero-budget-impact requirement, the "additionality" of sales requirement, and the "cost-effectiveness" requirement).

What is it, we should ask, that makes this commodity give-away program so popular? At least five separate political arguments have been made on behalf of EEP.

Increased Exports?

The first argument made for EEP is that it has worked to boost U.S. exports. It is true that both the volume and the value of U.S. farm exports have increased over the five years that the EEP has been in operation. In fact, U.S. farm exports have increased more than 50 percent in nominal value since FY 86 (up to $39.7 billion in FY 89).

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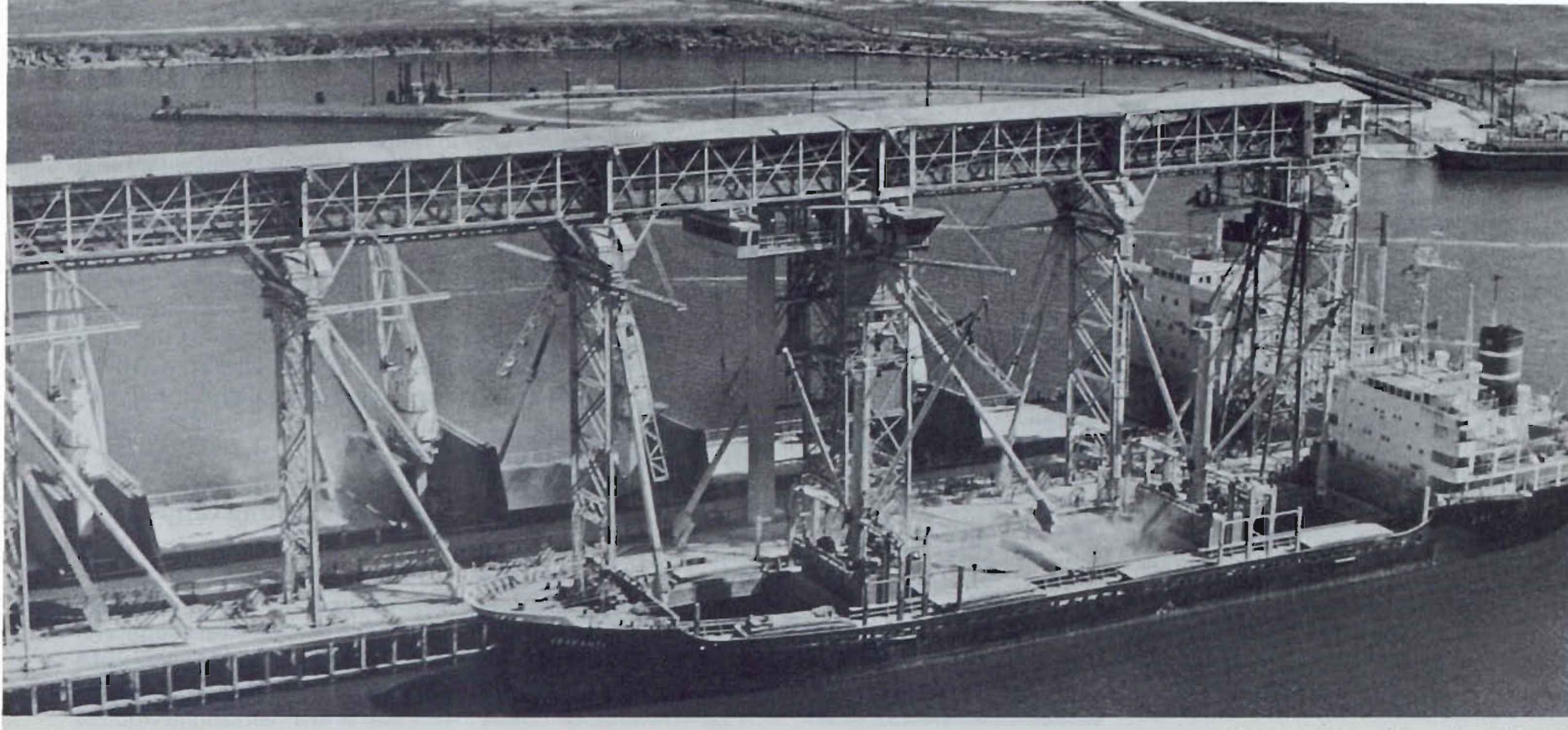

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But how much of this gratifying increase can be attributed to the EEP? In wheat markets, where the EEP has been used most heavily, the best studies we have tend to minimize EEP's contribution. According to one 1989 USDA study, EEP accounted for less than a third (30 percent) of the rapid expansion in U.S. wheat sales that took place between 1985 and 1987. More than two thirds of that sales expansion would have taken place even without an EEP—because of the combined impact of such things as lower U.S. commodity loan rates and lower foreign yields. USDA estimates that more recently, since 1987, only 20 percent of all wheat export expansion has been attributable to EEP.

EEP hasn't added much to foreign sales, because nine out of ten EEP bonus bushels simply displace sales that would have been made anyway.

Bailey has estimated that only about 10 percent of all U.S. wheat shipments going out under EEP in 1987-88 were *in addition* to shipments that would have been made anyway (and at higher prices). This means that EEP is ten percent an export "enhancement" program, and 90 percent an export "displacement" program. Instead of the "EEP," it should be called the "EDP." No wonder the Administration has decided to drop the "additionality" requirement.

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Take a look at two dramatic cases of export expansion in which EEP clearly played no role at all. The first of these is U.S. export sales to Japan. Since 1987, in just two years time, U.S. exports of agricultural products to Japan have increased in value by an astonishing 46 percent. What role has EEP played in this success? Obviously none, since EEP subsidies are not provided on sales to Japan. As a second case, consider corn sales to the Soviet Union. Last fall, the Soviet Union bought U.S. corn at a record rate—7.9 million tons in a six week period beginning October 1. In order to move all this corn, U.S. export handling facilities had to be stretched to their limit; the Soviets took more than 60 shiploads in November alone. What role did EEP play in this latest Russian grain sale success? Obviously none, since EEP subsidies are not provided for corn. U.S. corn growers once complained about being "excluded" from the program, but the difference made by exclusion is hard to discern. U.S. feedgrain exports, without any EEP, have actually grown more rapidly since 1986 than wheat exports with EEP—by 72 percent versus only 46 percent.

At times, the EEP program may have actually *constrained* U.S. farm exports. It has done this first by putting a cumbersome layer of company bids and CCC bonus bushel authorizations between normally efficient private sector exporters and their customers overseas.

Second, it slows sales by encouraging a hesitant attitude on the part of eligible importers; these importers don't want to buy from the U.S. until they know exactly how many EEP bonus bushels the CCC will make available. The uncertain availability of such bushels, especially since the 1988 drought, may have reduced the volume of purchases finally made.

Third, the EEP has constrained exports by discriminating against a few good customers that have not been made eligible—such as Japan and Korea, and until 1986, the Soviet Union. It is interesting to note that Korea has expanded its wheat purchases from countries other than the U.S. since 1986, when it was excluded from the program. And the Soviet Union, before it was made eligible in 1986, bought considerably less wheat from the U.S. than it would have otherwise been *obliged* to buy under the terms of its bilateral grain trade agreement. The EEP may even be undermining some U.S. sales because of the perverse incentive provided to those good foreign customers who *are* eligible. One hears stories about foreign customers that have gone out of their way to make additional purchases from the EC, so as to ensure that their normal purchases from the U.S. remain eligible for EEP subsidies.

Cost Effective?

Some supporters of EEP rest their case not on an exaggerated claim of huge export gains, but instead on a second claim, a somewhat less direct claim of "cost-effectiveness." They argue that *any* trade gain achieved from EEP would be worth it, since the program "costs us nothing." Inside the Office of Management and Budget (OMB), to be sure, accounting of the program has been contrived to show that it requires no new outlays. But this is only a fiction of no cost, achieved by the dubious practice of assigning *no value* to the hundreds of millions of dollars in CCC commodities that were originally bought by the government and have now been given away under the program.

To say that it costs the government nothing to give away commodities that it "already owns" is an argument that insults our common sense. It is a bit like saying it would cost the government nothing to give away Yellowstone Park, or that it would cost me nothing to give away my house and car.

If we value the commodities being given away at their actual price in the marketplace, we find that the EEP is anything but free, and far from cost-effective. Between 1985 and 1987, the CCC gave away $1.24 billion worth of government-owned wheat to U.S. exporters under EEP, in order to achieve just a 305 million bushel increase in U.S. wheat exports. This translates into a cost to the government of $4.08 for every bushel of added exports achieved under EEP, according to estimates by Coughlin and Carraro of the St. Louis Federal Reserve. The average U.S. Gulf export price for wheat during this period was only $3.16 a bushel. In other words, if the purpose of the CCC during this period was to dispose of surplus wheat, it would have been almost a dollar a bushel cheaper simply to buy surplus wheat on the free market and then destroy it, rather than to give it away under EEP in the vain hope of producing additional foreign sales. No wonder the Administration has decided to drop the cost-effectiveness test previously applied to the program.

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Pressure on Competitors?

A third argument sometimes made on behalf of EEP is that it helps the U.S. put "pressure" on competitors abroad, especially the European Community. This is a particularly dubious argument, because, in budget terms, the EEP costs the EC much less than it costs the United States. Moreover, under current political circumstances in Brussels, added budget costs are also easier for the EC to absorb.

In sharp contrast to just a few years ago, the EC today is under very little farm budget pressure. Expenditures are down, thanks to higher world commodity prices since the summer of 1988, and EC revenues are up—thanks to a decision by the European heads of government (taken in February 1988) to enlarge the Community revenue base by roughly 25 percent. The Common Agricultural Policy (CAP) now consumes only 55 percent of the Community budget, compared to as much as 70 percent just a few years ago.

Surplus stocks are also less of a problem for the Community today. Since 1985, EC cereal stocks have fallen by 54 percent, beef stocks by 82 percent, and butter stocks by 97 percent. EC exports, meanwhile, have continued to grow. In 1985-86, the year that the EEP began, the EC exported roughly 14.3 million tons of wheat. Last year (1988-89), despite the EEP, they exported 20 million tons of wheat, a *40 percent* increase.

To be sure, in order to keep these foreign sales growing in the face of EEP, the EC has been obliged to spend a bit more on its export restitutions. But even so, it has spent much less to combat the EEP than the U.S. taxpayer has spent to deploy the EEP. The added subsidy cost to the EC of combating the EEP has been estimated by the Australian Bureau of Agricultural and Resource Economics at roughly $380-430 million for 1987, and roughly $270-320 million for 1988. This is an affordable burden for the Community—equal to only about 1.5 percent of the total EC farm budget. In straight dollar terms, this EEP burden on the Community budget is only about half the annual budget burden that EEP represents for taxpayers here in the U.S.

GATT Bargaining Chip?

Some defenders have tried to argue that EEP's doubtful success in capturing foreign markets or in pressuring the EC budget should all be seen as secondary. Its real value, they say, is as a "bargaining chip" in the current Uruguay Round of GATT negotiations. Without an export subsidy program of its own to trade away, the United States will stand little chance in GATT of persuading the EC to give up its export restitutions. The analogy is sometimes made to an arms control negotiation, and the presumed need to "deploy" an EEP (like we deployed Pershing II missiles in Europe) in order to get a multilateral agreement to scrap all export subsidies (just like the deal we finally got from Gorbachev to scrap all Euro-missiles).

This argument has two problems. First, recall the failure of our EEP deployments, so far, to put any real budget or market-loss pressure on the EC. As bargaining chips go, the EEP isn't weighty enough to threaten the Community, or to be traded away against EC export subsidies, which dwarf the EEP in size by a margin of roughly 10 to 1. Unfortunately, though, the EEP has been just large enough to give the U.S. "dirty hands" in GATT, and to attract a barrage of criticism towards the United States from those in GATT that ought to be our natural allies against the Community—the Canadians and the Australians. The EEP has so far given U.S. negotiators in GATT an export subsidy program just large enough to blur differences between U.S. and EC policy, and just large enough to attract criticism from the Cairns Group, but not large enough to trade away for anything.

A second problem with the bargaining chip argument is that some U.S. defenders of the EEP have never really stood ready to trade it away. Instead of using EEP to get a better deal in the GATT negotiations, their strategy has been one of using the GATT negotiations to get a bigger EEP. These EEP enthusiasts wrote into the 1988 trade act a provision for *expanded* EEP activity ($2 billion per year during FY 90-FY 92), in the event that the GATT negotiations should fail. Then they increased the chances of such a failure, by resisting any separate deal on export subsidies at the December 1988 Mid Term Review negotiations in Montreal. Then, in 1989, EEP supporters in the Senate launched an initiative to insert into the 1990 Farm Bill a provision that would trigger still more EEP spending (as well as retaliation under Section 301 of the Trade Act), if foreigners do not make adequate concessions to the United States by the end of the Uruguay Round. Given the low probability that our EEP threats will budge the EC negotiating position in Geneva, this legislation seems more a clever attempt to boost EEP through GATT, rather than a genuine attempt to help GATT with EEP.

Subsidy For U.S. Farmers?

Cynics might conclude that the *real* political justification for EEP has nothing to do with export promotion or trade reform. EEP, they might say, is just another domestic farm subsidy program. It enjoys strong political support because it is a subsidy benefit to U.S. farmers.

In the strange case of EEP, however, even these cynics are wrong. The sad fact is, most EEP subsidy benefits never reach U.S. farmers. The biggest recipients, instead, are the foreign customers who buy under EEP, and, to a lesser extent, the agribusiness export firms who sell under EEP.

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Remember that only about 10 percent of all U.S. wheat sales exported under EEP have been "additional" to sales that would have been made anyway, on straight commercial terms at a higher price. What this means is, roughly 90 percent of our EEP sales give foreign customers a chance to make their normal purchases from us at a *lower than normal price.* The result is a massive income transfer to foreigners, paid for by the U.S. taxpayer.

And just who are the chief recipients of this inadvertent foreign aid? In recent years, our two largest EEP customers abroad have been the Soviet Union and the People's Republic of China. The total value of EEP bonuses on wheat sold to the Soviet Union since 1986 amounts to roughly $600 million. Do U.S. farmers really want their scarce budget dollars to be spent doing favors for central planners and state trading ministries in Moscow and Beijing?

It is true that a small share of EEP sales are "additional" to those that would have been made otherwise, so a small share of the benefits from EEP do finally go to some recipients inside the U.S. economy. But even here, the primary beneficiaries are *not* U.S. farmers. The U.S. government is, to some extent, a beneficiary, because of savings in storage costs. And in the private sector, there are winners among the off-farm "agribusiness" industries that end up handling a slightly higher volume of trade generated by EEP. These agribusiness winners include, most of all, the private trading firms that actually bid for and receive the "bonus bushel" subsidy payments. It is ironic that so many U.S. farm groups, who have traditionally been suspicious of agribusiness, are now pushing so hard for EEP—a subsidy program which, inside the U.S. economy, primarily benefits agribusiness. It is only slightly less ironic that a lead trading firm such as Cargill (which received more than $445 million in bonus bushel value over the first four years of the program), has actually been a consistent *opponent* of EEP, at least for bulk commodities like foodgrains. It is somehow fitting, in this upside down world of EEP, that some of those who seem to benefit from the program do not support it, and vice versa.

How much EEP subsidy benefit actually reaches U.S. farmers? The USDA has never provided an authoritative estimate. And perhaps for good reason, since it could be argued that the net short run effect of EEP is actually to *lower* commodity prices and hence to lower U.S. farm income. Because most EEP sales are not additional to sales that would have been made anyway, the reduction in CCC stocks, that takes place because of EEP, puts some short term downward pressure on commodity prices. The significant number of U.S. farmers that are not participating in government income protection programs can be hurt, at least in the short run, when these market prices fall. Meanwhile, those U.S. farmers who are participating in commodity programs will not gain any short term income from EEP, because their income per bushel of production will depend upon such things as loan rates and cash deficiency payments, which are separately determined.

Perception vs. Reality

I am, therefore, at a loss to explain why so many U.S. farm groups, and their friends in Congress, have staked so much on a defense of the Export Enhancement Program. Maybe in the political world of EEP, perception is more important than reality. Having cultivated the perception that EEP boosts exports, benefits U.S. farmers, and pressures others toward trade reform, the architects of this program are likely to continue defending the program and reaping political benefits for as long as the perception can be maintained.

The politics of perception, however, can quickly turn sour. EEP advocates should take pause, during the 1990 Farm Bill debate, to recall an earlier political experience with farm export subsidies. In the summer of 1972, USDA officials were caught providing several hundreds of millions of dollars in unnecessary export subsidy payments to private U.S. trading companies, at a time of rapidly tightening supplies and rising food prices, in the aftermath of large grain purchases by the Soviet Union. What followed was a series of partisan and inflammatory statements from Congress and from the press, blaming everything from inflation at home to food shortages abroad (the "world food crisis") on USDA's maladministration of these subsidies. This 1972 "Great Grain Robbery" experience gave to farm export subsidies—and to all those who had supported and administered them—a public relations black eye. Explicit farm export subsidy programs were terminated as a result, and it took more than a decade (until the time EEP was launched in 1985) for the political climate in Washington to get over the experience.

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We are not likely to see a replay of these 1972 events any time soon. But U.S. Government stocks in 1990 will be tight enough, at least in foodgrains, to make possible a sudden change in market conditions, and if so, a suddenly *adverse* political perception of the EEP. If a new encounter with bad weather pushes food prices sharply upward, or perhaps curtails the availability of surplus foodgrains for famine relief, then the happy perception that has until now been cultivated—that EEP *is responsible* for higher exports, higher farm prices, and surplus stock reductions—could well become a politically unhappy perception, and a major embarrassment, for some of today's supporters of the EEP. C

For More Information:

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Cletus C. Coughlin and Kenneth C. Carraro, "The Dubious Success of Export Subsidies for Wheat," Federal Reserve Bank of St. Louis, November-December 1988, p. 44.

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