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6 The Political Economy of the Export Enhancement Program for Wheat

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U.S. agriculture faced severe economic problems in the early 1980s. The problems are apparent in the data on farm income and the farm sector's balance sheet. Real farm income (including government assistance) in 1980–84 averaged about half of its level of the period before the commodity boom in the 1970s. The U.S. Department of Agriculture's (USDA) estimate of farm equity, the value of farm assets minus liabilities, declined from $1.14 trillion (1987 dollars) at the end of 1980 to roughly half of that value, $0.6 trillion on January 1, 1985. U.S. wheat growers were among the hardest hit.

The economic problems of wheat growers were addressed in several ways, some of which caused more problems than they solved. The price paid to farmers for wheat placed in government ownership was increased to $4.00 per bushel for the 1982 crop. It had been only $1.37 up to 1975. U.S. wheat acreage planted expanded 45 percent, from 59 million acres in 1973 to 86 million acres in 1982, and the USDA increased its wheat stocks to over a billion bushels in 1982, the highest level since the early 1960s. In reaction, the Payment in Kind (PIK) program was introduced and idled 30 million acres of wheat base in 1983, the largest supply control effort ever. In 1984, direct payments to wheat growers rose to exceed $1.5 billion. Yet none of these measures was capable of stemming the decline in income and equity values through 1985. Because weak export demand was a key element of wheat's economic problems, it was natural to look to export promotion as an additional policy tool.

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6.1 The Birth of the Export Enhancement Program

In 1983 the Reagan administration, after debate settled only at the cabinet level, accepted the idea of ad hoc subsidized exports of Commodity Credit Corporation (CCC)-owned wheat to targeted North African markets where European Community (EC) wheat was being sold with the help of their export subsidies. This was intended to serve the dual purpose of reducing excessive stock levels and retaliating against EC export subsidies. This venture was a substantial political success, affording an opportunity to attack the EC, please farmers, and hold off congressional pressure for more sweeping programs. The impetus was thus established that led eventually to the full-fledged Export Enhancement Program (EEP).

In Congress, the idea of legislation to target in-kind export subsidies at the EC did not prevail when it was first seriously considered in 1983. The principal reason given by opponents was the worry that such legislation would trigger a trade war in which the EC would increase their subsidies and perhaps withdraw previously negotiated concessions such as their duty-free binding on U.S. oilseed products and feed grain substitutes. In addition, the secretary of agriculture already possessed sufficient authorities for ad hoc export subsidies as needed for surplus commodity management or strategic purposes.

Two years later, as the 1985 farm bill deliberations began, the situation was different in two respects: farm groups had refined their general support for export promotion to more concrete proposals, and U.S. wheat exports had declined still further while the EC's grew. In this situation the administration's desire to continue ad hoc export subsidies without binding legislation was no longer politically tenable.

Senator Robert Dole (R-Kansas) took the lead in organizing a series of meetings in the spring of 1985 to get the Reagan administration to establish a targeted export subsidy program focused on grains, especially wheat. Representatives of the wheat growers as well as other farm groups attended these meetings in Dole's office. In May 1985, the administration (represented by the Office of Management and Budget [OMB] and the USDA) and the Senate leadership (principally Dole and Senator Edward Zorinsky [D-Nebraska]) agreed to implement, under existing USDA authorities, an Export Enhancement Program.

Politically, the EEP was given the breath of life by a conjunction of interests represented by three individuals: Senator Zorinsky's strong desire, as the ranking Democrat on the agriculture committee and representative of Nebraska, for a substantial export subsidy program; budget director David Stockman's need for Democratic votes on key economic legislation; and Senator Dole's brokering savvy, with interests in supporting both the administration (as majority leader) and Kansas wheat growers. Stockman agreed that the administration would implement an export subsidy program, in exchange for Zorinsky's vote on the budget resolution containing the Reagan administration's fiscal propos-

als, with the subsidies to take the form of unwanted CCC surplus commodities with a zero budget score.

The agreed-upon program committed $2 billion worth of CCC-owned commodities to be made available as a bonus to U.S. exporters to expand sales of U.S. agricultural commodities in targeted markets. The objectives stated were to increase U.S. farm exports and to encourage trading partners to begin serious negotiations on agricultural trade problems.

Guidelines for the EEP, established by the Economic Policy Council of the White House, were that each subsidized sale should meet the following criteria: (1) additionality, that is, net increase in export sales caused by the subsidized sale; (2) targeting to displace competing exporters who are subsidizing their sales; (3) a net gain to the U.S. economy; and (4) budget neutrality. Each proposed EEP initiative was to be tested against these criteria by an interdepartmental committee chaired by the U.S. Trade Representative and the USDA that included representatives from the OMB, the Council of Economic Advisers (CEA), the departments of Treasury, State, Labor, and Commerce, and the National Security Council (NSC). It was never publicly stated how the "net gain to the U.S. economy" and "budget neutrality" criteria were to be defined and measured. Participants in the process indicated that criterion (3) was not a factor in interagency debate, although (1), (2), and (4) were.

The Food Security Act as finally enacted in December 1985 codified the EEP essentially as the administration had established it six months earlier. The main issues, as often in enabling legislation, were what the executive branch "shall" (be required to) do and "may" (has discretionary authority to) do. The 1985 act required the secretary of agriculture to provide CCC commodities at no cost to "United States exporters, users, and processors and foreign purchasers," and required that a total of $2 billion in CCC commodities be used for this purpose during the three fiscal years ending September 30, 1988. The purposes the subsidized exports were to serve are broadly stated: in addition to combating other countries' subsidies and the high value of the dollar, export subsidies may be used to offset "the adverse effects of U.S. agricultural price support levels that are temporarily above the export prices offered by overseas competitors in export markets" (*Food Security Act of 1985, U.S. Statutes at Large* 99:1483).

In addition, the act authorized the unlimited use of cross-subsidization, that is, the use of one CCC commodity to subsidize the export of another. This was politically important because many commodity interests, including processed products and products which did not have price support programs, prevailed upon the agriculture committees for support. Egg producers and pork producers, for example, testified that they needed assistance in competing with EC export subsidies. But no CCC stocks of these commodities existed. The legislation shared EEP benefits across commodities by permitting CCC wheat stocks to be used to subsidize egg or pork exports.

The EEP was not subject to discipline in the annual appropriations process,

because the farm support programs are "entitlements"—the appropriations committees provide open-ended funding for the Commodity Credit Corporation to achieve its price support mandates. The committees do not control how the CCC uses its acquired commodity stocks. Congress could have brought budgetary disciplines to bear by scoring EEP costs in Budget Committee proceedings. However, Congress agreed with the OMB on zero scoring for the EEP. The principal argument was that CCC commodities cost so much to store that it was worth as much to give them away as to keep them. In addition, to the extent that increased exports increased the U.S. market price, deficiency payments for wheat and other target-price commodities would be reduced.

The Export Enhancement Program came into being with very little opposition. Why was the way so clear? The natural opponents of an export subsidy are U.S. domestic wheat buyers and foreign wheat producers. In the case of the EEP, U.S. millers were diverted by their participation in subsidized flour exports and by the release of CCC stocks to pay the subsidies. The bakers and broader consumer groups were relatively weak participants, and their participation in the 1985 farm bill debate was focused on opposition to acreage controls and on limiting budgetary outlays. In summary, the Export Enhancement Program was enacted in 1985 because wheat growers and exporters asked for it, and no interest group opposed it, except some economists in general terms. Because the pressure to assist agriculture was strong, and was countered only by budgetary pressures, the OMB finding that the EEP would be budget neutral ensured its supporters of an easy political victory.

6.2 Consequences and Evaluation of the Program

Questions were being raised about the effectiveness of the Export Enhancement Program even before its legislative enactment. The administration announced its first EEP initiatives in May 1985. By October only two sales had been made. In October and November the House Committee on Agriculture's Subcommittee on Department Operations, Research, and Foreign Agriculture held hearings to review complaints about EEP administration.

The procedures for implementing the EEP were far from clear. There were (and are) two main steps: administration approval of an EEP initiative, and the USDA's acceptance of exporters' bids for bonuses under the initiative. The approach raises questions of how the USDA can determine, for each proposed sale, what the competitor's price is. Wouldn't the competitor's price itself be affected by an EEP? And is there sufficient incentive for U.S. commercial exporters to obtain the highest possible market price?

Statistics of EEP shipments are shown in table 6.1. After a slow start, EEP exports reached 26.6 million metric tons in fiscal 1988, about half of all U.S. wheat exports. The average subsidy reached $38 per ton in 1987. A price wedge this large on substantial quantities would be expected to make a noticeable difference in world trade flows and prices.

Table 6.1 **Export Enhancement Program (EEP) Wheat Sales and Bonuses**

Fiscal Year	EEP Sales Metric Tons (millions)	Total EEP Bonus Dollars (millions)	Average EEP Bonus $/mt	Total U.S. Exports[a] Metric Tons (millions)	EEP Share[b] (%)
1985	.5	11	21.84	28.0	2
1986	4.8	126	26.20	20.7	23
1987	14.1	541	38.33	28.1	50
1988	26.6	819	30.83	40.6	66
1989	16.0	288	18.05	37.6	43
1990	14.3	241	16.84	33.2	43
1991	17.7	767	43.18	26.7	67
1992	19.7	813	41.14	34.3	58
1993	21.6	1281	33.82		

Source: Economic Research Service, USDA.

[a]Fiscal year exports, which differ from crop-year data used elsewhere in this paper. Constructed from USDA monthly export statistics.

[b]EEP tonnage as percentage of total export tonnage.

The USDA uses a wheat simulation model in which each million-ton increase in wheat exports generates an increase of ten cents per bushel in the U.S. farm price of wheat. Each ten-cent rise in the price of wheat reduces deficiency payments by $174 million. Empirical studies suggest that an EEP of 20 million tons adds 2 to 6 million tons to U.S. export demand. With a $50 per ton bonus level, the budget outlays for the EEP are $1 billion annually (recent levels). The 2 to 6 million ton increase in exports causes the wheat price to rise twenty to sixty cents per bushel and hence budget outlays to decline $350 to $1,050 million annually. Thus, if the high end of "additionality" pertains, which is what the USDA assumes, the EEP is budget neutral.

The main losses from the Export Enhancement Program accrue to domestic buyers of U.S. wheat. The exact incidence on the buyers' side—among farmers who feed wheat, millers, bakers, retailers, and final consumers—has not been estimated. Because domestic final demand for foods containing wheat is quite inelastic, domestic consumption of these products is unlikely to change appreciably because of the EEP, and in fact domestic use has been quite stable over time despite large changes in wheat prices. It is therefore unlikely that the EEP reduced the demand for, and thus the returns earned by, processors, distributors, or other middlemen. Certainly the evidence in the political debate is consistent with this conclusion. Millers and bakers who took public positions favored the Export Enhancement Program (usually because they had export as well as domestic interests).

Each increase of ten cents per bushel in the price of wheat raises farm income by $60 million and reduces consumers' surplus by $120 million (Salathe 1991). The consumer cost estimate assumes that farm price increases for all

Table 6.2 **Economic Gains from the Export Enhancement Program (EEP)**

Additionality	.1	.3
	Millon Dollars Annually	
Cost of EEP subsidies	−1000	−1000
Deficiency payment reduction	350	1050
Subtotal: budgetary gain	−650	50
Crop producers' income gain	120	300
Livestock feeders' gain	−40	−100
Consumers' gain	−200	−500
Total U.S. gain	−770	−250

Source: Salathe (1991) and calculations described in text.

domestically used wheat are passed on to consumers without any change in the farm-to-consumer markup or profits in the wheat processing industry. The farm income increase is only about one-fourth of the rise in the market value of the wheat crop because three-fourths of wheat production are protected by deficiency payments which decline cent for cent as the market price rises.

The overall domestic welfare effect of the EEP can be estimated by summing the budget, consumer, and producer changes if we assume that the farm income change is a change in economic rents (i.e., farmland and farm operator labor taken as fixed in supply). For the range of additionality of 0.1 to 0.3, the EEP, at its average recent size of about 20 million tons and cost of $1 billion annually, generates the results shown in table 6.2. While an optimistic assumption of additionality permits the EEP to achieve the objective of budget neutrality, no assumption permits the program to achieve its cost-effectiveness objective of providing a benefit to the U.S. economy. Indeed, by these estimates the EEP is a particularly inefficient income transfer program, generating almost $1 in deadweight losses (from the U.S. viewpoint) for each $1 of farm income gain even under an optimistic additionality assumption. The main reason for the large net U.S. losses is that so much of the subsidy is a transfer to foreign buyers of U.S. wheat.

6.3 Political Response to the EEP in the 1990s

In 1990 the legislation authorizing the EEP (and other farm programs) expired and was reconsidered in a comprehensive set of hearings (U.S. House 1991; U.S. Senate 1991). This provided a convenient opportunity for interest groups to express second thoughts and to suggest modifications of the EEP. The National Association of Wheat Growers, as well as representatives of other commodities using the program, were totally supportive of continuation of the EEP without substantial change. Concerns that had been expressed in the 1985 House hearings about targeting as opposed to a generally available subsidy

disappeared. Grain users might have been expected to be more critical, but more of them supported the EEP in 1990 than in 1985. The American Bakers Association, the Biscuit and Cracker Manufacturers' Association, and the North American Export Grain Association all testified in favor of continuing the program.

Because of firm support from commodity and agribusiness groups, and weak opposition, the EEP emerged unchanged in structure and strengthened in budget in the 1990 Farm Act. EEP spending was far higher in fiscal 1991 through 1993 than in any previous three-year period (table 6.1). The solid political support was attributable not so much to particular export achievements of the EEP, but to farmers' general satisfaction with the recovery of farm income from mid-1980s lows and the role of the commodity programs in that recovery. CCC wheat inventories had been sold off, deficiency payments protected producers from low prices in 1986, the export market had recovered with the dollar's decline from its 1985 high, and reduced output boosted wheat prices back to 1980–81 levels in 1989 and 1990. Farm interests in the 1990 farm bill debate were devoted mainly to attempting to forestall the budget cuts (about $2 billion annually) that the Bush administration was calling for. The EEP was thus seen as a piece of a set of programs that were working.

Beyond general satisfaction with the situation, EC subsidized exports remained a principal threat to U.S. grain producers. The EEP was seen as particularly valuable in this situation, with the Uruguay Round languishing in its fifth year of negotiations. The 1990 act authorized the EEP at a level of not less than $500 million annually and explicitly authorized cash as well as in-kind subsidies. It said that the only purpose of the EEP was "to discourage unfair trade practices" (U.S. House 1990, 335). The context for this focus was the continued expansion of the European Community's subsidized exports and the EC's intransigence on agriculture in the Uruguay Round, then scheduled for completion in December 1990. The Omnibus Budget Reconciliation Act, enacted in October 1990 along with the Farm Act, contained a "GATT trigger" that required spending $1 billion annually on the EEP if no Uruguay Round agreement had been reached by June 30, 1992. (Since it turned out that no agreement was reached by that time, EEP spending duly proceeded at about the $1 billion rate.)

Opposition to the EEP in 1990 was mitigated because farm bill reformers focused on other policies. The only organized reform effort, by a coalition of conservative Republicans and urban Democrats in the House of Representatives, brought to the floor of the House amendments to reduce or eliminate the sugar, wool, and honey programs, and eliminate deficiency payments to farms with over a million dollars in sales or farmers who earned more than $100,000 from off-farm sources. The amendments all failed. They had more apparent popular appeal than an anti-EEP amendment would have; this helps explain why none was offered.

A second important factor mitigating opposition to the EEP was its continu-

ing to be scored as budget neutral. The reforms that were successful in 1990, most notably the introduction of a 15 percent reduction in deficiency payments by making 15 percent of each producer's base acreage ineligible for payments, were driven by the budget reconciliation agreement to cut $13 billion from farm program spending over the five fiscal years 1992 through 1996.[1] The $1 billion annual spending on the EEP would have been a prime target for cuts if the program had not been scored as budget neutral by the OMB.

Finally, it is noteworthy that the EC has introduced significant reforms of the Common Agricultural Policy (CAP), including acreage set-aside and other measures to reduce outlays on their export subsidies, and that the permanence of these reforms has been strengthened by the General Agreement on Tariffs and Trade (GATT) on agriculture reached in January 1994. This agreement requires that both Europe and the United States reduce export subsidies substantially over a five-year period. The United States's willingness to spend on the EEP quite likely had a role in encouraging these reforms, though how important a role is unclear.[2]

6.4 Conclusions

Interest-group outcomes of the EEP can be summarized as follows. Wheat producers were substantial economic gainers from the program. Wheat exporting businesses were also supportive of the EEP, and were winners. Other agricultural producers, notably, feed grains, gained by obtaining a piece of the EEP action and also supported the program. The losing groups—domestic grain processors and consumers—did not visibly oppose the program.

Perhaps the most striking feature of the political economy of the Export Enhancement Program is how little impact standard economic arguments have had. Economists have produced many analyses showing that the program, even as a second-best measure, generates a net loss to the U.S. economy.

The biggest losers from the Export Enhancement Program are buyers of

1. This cut was calculated from a five-year baseline of future spending, not from current (1990) levels. As it turned out, farm program spending was not $13 billion below the 1990 baseline. Indeed, the cuts notwithstanding, farm program spending between 1992 and 1995 has exceeded the baseline level that was projected *before* the "13 billion cut."

2. Although it is even more conjectural than the earlier calculations, CAP reform and GATT could well reduce EC wheat exports by 3 to 4 million tons annually and raise the U.S. market price by twenty to thirty cents per bushel. The resulting gain for U.S. producers would be $120 to $180 million annually, and the gains to taxpayers would be $350 to $520 million (because of fewer deficiency payments). U.S. consumers would lose $240 to $360 million. The overall net gain to the United States, roughly equal to the price increase times wheat exports, would be $230 to $350 million.

Suppose the EEP accelerated CAP reform by five years. Then the EEP generated $1.1 to $1.8 billion for the United States. The overall U.S. cost of the EEP between 1990 and 1992 was $510 million annually, or about $2 to $3 billion between 1986 and 1993. These calculations are of course crude, but they indicate that it is quite difficult to obtain any net U.S. gain from the EEP as a strategic investment, even under the assumption that it successfully induced policy changes in the EC.

wheat, with losses of $250 to $600 million per year according to estimates presented earlier, with recent world price data suggesting that the lower end of the range is more likely. But no buyers of wheat—millers, bakers, livestock producers, or consumers of retail products containing wheat—have raised politically significant objections to the program. Agribusiness interests probably did not bear any losses. Livestock feeders' costs have not been substantial, and a feeling of solidarity along with logrolling keeps them from opposing the program. Consumer costs are only about $1 to $3 per year per person, and the general public remains generally supportive of farmers according to polls.

In short, the Export Enhancement Program has proved a political winner because

- wheat producers see a benefit from it;
- wheat producers have a unified view on the issue, and they have effective channels of influence through the congressional Agriculture committees;
- wheat buyers have not opposed the program;
- the program has been accepted as budget neutral.

There are two points of vulnerability for the Export Enhancement Program in the near future. The first is in the budgetary arena. Budget neutrality arguments have been abandoned now that CCC stocks are no longer used as bonuses and apparent effects on U.S. prices are small. EEP spending has already been cut about $200 million for fiscal year 1995. The second point is that the GATT in agriculture will require a further reduction of the EEP over time. This makes EEP reform part of a policy package that will make U.S. farmers as well as nonfarmers better off than at present.

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