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James R. Walczak

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ARTICLES

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JAMES R. WALCZAK

I. INTRODUCTION

On January 4, 1980, in response to the invasion of Afghanistan by the Soviet Union, President Carter imposed controls on the exportation of various commodities to the U.S.S.R.[1] Included among these commodities were wheat, corn, soybeans, and soybean products. On January 6, exporters of these commodities urged that the Government "step into the shoes" of the Russians and assume the affected contracts. The following day, Vice-President Mondale publicly announced the Government's commitment to take over the contracts.

The objective of this article is to explain and analyze the legal and practical aspects of the embargo and the Government's contract assumption operation. It is not the purpose of the author to examine the wisdom or effectiveness of the embargo. That subject has already been discussed rather thoroughly in the popular press, as well as more specialized publications.[2]

As with most legal problems, however, a simple bare-bones analysis of the legal authority for the embargo and the contract assumption operation will shed little light on the true dimensions of the problems which

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James R. Walczak is a staff attorney in the Foreign Agricultural and Commodity Stabilization Division, Office of the General Counsel, U.S. Department of Agriculture. B.S.F.S., M.L.T., Georgetown University; M.A., J.D., University of Denver. The opinions and views expressed in this article are the author's alone and do not necessarily represent the official position of the United States Government.

1. The controls were initially implemented by regulations which were issued by the Department of Commerce on January 7, 1980. *See* Fed. Reg. 1883 (1980). They were subsequently amended on February 4, 1980. *See* 45 Fed. Reg. 8289 (1980). The embargo also included a ban on the sale of American high technology products to the Soviet Union and the curtailment of Soviet fishing privileges in American waters. N.Y. Times, Jan. 5, 1980, at 1, col. 6.

2. *See, e.g.*, de Borchegrave, *Embargo is Failing*, NEWSWEEK, Mar. 10, 1980, at 60; Gilpin & Bienen, *Economic Sanctions: An Obsolete Weapon?*, FORBES, Feb. 18, 1980, at 91; Morgan, *Politics of Grain*, ATLANTIC, Feb. 15, 1980, at 29; Paarlberg, *Lessons of the Grain Embargo*, 59 FOREIGN AFF. 144 (1980); Wright, *Grain Embargo Backfires*, NEW STATESMAN, Feb. 1, 1980, at 157; *America's Leaky Grain Embargo*, U.S. NEWS & WORLD REP., Mar. 24, 1980, at 12.

faced Government officials on the early days of 1980. For purposes of explication and elucidation, the nature and purpose of the contract assumption operation and related actions will be set forth in some detail. An examination of various accounts of these actions reveals a wide misunderstanding of: (a) what the Government actually did; and (b) why the Government did what it did.[3] In this respect, it is hoped that one of the primary contributions of this article will be an accurate explanation of these actions. A secondary, but equally important objective is to highlight in a general way the practical difficulties of imposing and maintaining an embargo of agricultural exports. These difficulties comprise a mixture of economic, psychological, and political factors which were clearly illustrated by the debate that took place within the Reagan Administration prior to the lifting of the embargo.[4] In a broader sense, the study of the imposition, implementation, and lifting of the embargo can reveal the practical limitations on the future exercise of the economic power of the United States in the international arena.[5]

II. IMPOSITION OF THE EMBARGO

A. *Legal Authority to Impose the Embargo*

The Soviet Union invaded Afghanistan on December 27, 1979. Within two weeks, the President announced and implemented a complete range of controls on the exportation of agricultural commodities to the U.S.S.R., pursuant to authority invested by the Export Administration Act of 1979.[6]

The general thrust of the Export Administration Act is set forth in

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3. A measure of responsibility for this confusion must be attributed to the government itself. While the policies described below were formulated within a short period of time, they were not conceived and implemented simultaneously. Nor were they fully understood by all the many voices speaking for the various government agencies involved at that time. Consequently, a fair degree of confusion existed for some time, and still persists to this day.

4. Rightly or wrongly, many farmers and their Congressional representatives viewed the embargo as a continuing source of harm to the farm economy. They also viewed the embargo as being basically unfair. At the same time, the Reagan Administration has been attempting to project a clearer, "tougher" U.S. position on U.S.-Soviet relations. Not surprisingly, therefore, the embargo was a very sensitive emotional and political issue which President Reagan had inherited from the previous administration.

5. Further limits may be imposed by the Senate Agricultural Committee. As of this writing, the Senate is taking steps to make it financially prohibitive for the government to use a commodity embargo as a foreign policy weapon. If approved, the government would guarantee 100% parity for their commodities in an embargo of only farm products against a major export customer. Den. Post., May 13, 1981, at 12, col. 1. *See* note 50, *infra*, and accompanying text.

6. 50 U.S.C. app. § 2401 (Supp. IV 1980). It should be noted that actions taken under the Export Administration Act are exempt from the requirements of the Administrative Procedure Act. *See* Section 13 of the Act, 50 U.S.C. app. § 2412. *See generally* Dvorin, *The Export Administration Act of 1979: An Examination of Foreign Availability of Controlled Goods and Technologies*, 2 N.W. J. INT'L L. & BUS. 179 (1980); Note, *The Trade Agreement Act of 1979: Title IX Enforcement Provisions*, 14 J. INT'L L. & ECON. 123 (1980); Note, *Reconciliation of Conflicting Goals in the Export Administration Act of 1979—A Delicate Balance*, 12 LAW & POL'Y INT'L BUS. 415 (1980).

Section 3 of the Act, which states the policies in furtherance of which the President may impose export controls. These policies may be broken down into four general categories: national security, foreign policy, short supply, and foreign boycotts. For obvious reasons, only the former two categories served as a basis for justifying the President's imposition of the Soviet grain embargo.

1. National Security

The national security provisions of the Act are set forth in detail in Section 5. The authorities of that section may be used only to the extent necessary "to restrict the export of goods and technology which would make a significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security of the United States."[7] With respect to agricultural commodities, this rationale was applied to wheat and corn.[8]

There is no provision for a Congressional veto of action taken under the authority of Section 5. Also, although the statute provides for a periodic review of export controls based on national security,[9] there is no "sunset" provision automatically causing such controls to lapse after a certain period of time.

2. Foreign Policy

The foreign policy provisions of the statute are contained in Section 6. For purposes of foreign policy, export controls may be implemented only to the extent necessary "to restrict the export of goods and technology where necessary to further significantly the foreign policy of the United States or to fulfill its declared international obligations."[10] This rationale was applied to all commodities affected by the embargo.

The foreign policy provisions of the Act differ from the national security provisions in at least two important respects. First, if the President exercises the authority conferred by Section 6 with respect to agricultural commodities, he is required to "immediately report such prohibition or

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7. Section 3(2)(A), 50 U.S.C. app. § 2402(2)(A).

8. Many people question whether this rationale could properly be applied to agricultural commodities in view of the limited purposes of the embargo. They argue that the shipment of grain to the U.S.S.R. cannot be seen as making a "significant contribution to the military potential" of the Soviet Union. Conversely, Carter Administration officials argued that the term "military potential" must be read broadly so as to include a willingness to exert military force as a means of resolving problems in the international arena. In this respect, the grain embargo does detract from the military potential of the U.S.S.R. to the extent that it serves as an effective deterrent to further aggressive actions by the Soviet Union. In any case, as will be seen below, there are some very important differences between the national security and the foreign policy sections of the Export Administration Act, especially with respect to agricultural commodities.

9. Section 5(c)(3), 50 U.S.C. app. § 2404(c)(3). It should be noted, however, that the Department of Commerce has yet to promulgate the regulations under which such a review is to take place.

10. Section 3(2)(B), 50 U.S.C. app. § 2402(2)(B).

curtailment to the Congress, setting forth the reason therefor in detail."[11] Within thirty days after receipt of the report, Congress may by concurrent resolution disapprove the export controls, in which case the controls cease to be effective. In the present case, however, no serious attempt was made in the Congress to invoke this provision of the law in order to lift the embargo.[12]

Secondly, export controls based solely on foreign policy considerations automatically lapse after one year, unless the controls are specifically extended by the President.[13] Such an extension may only be imposed after the President has complied with the procedural and notification requirements of the Act.[14] It would therefore appear that the Congressional veto provisions as to agricultural commodities again became operative when President Carter submitted a report to Congress in January 1981 extending the export controls then in existence with respect to agricultural commodities.[15]

B. *Impact of the U.S.-U.S.S.R. Grain Agreement*

The embargo imposed by President Carter applied to a wide range of agricultural commodities. Of all the commodities embargoed, corn and wheat occupied a special place. In accordance with the U.S.-U.S.S.R. Grain Agreement of 1975,[16] eight million tons of wheat and corn were permitted to be shipped annually to the U.S.S.R.[17] Thus, the existence of the Grain Agreement had a significant impact on the substance and implementation of the embargo.

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11. Sections 6(e), 7(g)(3), 50 U.S.C. app. § 2405(e), 2406(g)(3).

12. As disenchantment with the embargo has grown, however, a number of serious attempts have been made to prohibit expenditures of public funds to enforce the embargo in the form of amendments to appropriation bills. None of these attempts have succeeded.

13. Sections 6(a)(2), (b), (e), 7(g)(3), 50 U.S.C. app. §§ 2405(a)(2), (b), (e), 2406 (g)(3).

14. Section 6, 50 U.S.C. app. § 2405.

15. This situation raises an interesting hypothetical. If the President exercised his authority to extend controls, and if the Congress acted to veto the extension, could the limitation on wheat and corn be successfully challenged in court on the grounds that the criteria for exercising the national security export controls authority have not been met?

It could be argued, perhaps, that the case for national security controls in this area has weakened considerably, since the element of surprise is no longer present and the Soviets have had time to adjust their internal marketing system and to find alternative sources of supply. Also, why is the shipment of eight million tons of grain not contrary to the interests of national security while amounts in excess of that level are? The counterpoint to this argument is that the primary national security basis of the grain embargo is its deterrent effect upon the Soviet Union. This rationale would apply regardless of whether the element of surprise was present, or whether the embargo was total or partial.

16. Agreement on the Supply of Grain, Oct. 20, 1975, U.S.-U.S.S.R., 26 U.S.T. 2972, T.I.A.S. No. 8206, *reprinted in* Mayer, *The Russian Grain Agreement of 1975 and Future United States Food Policy*, 7 U. TOL. L. REV. 1031, 1069 (1976) [hereinafter cited as the Grain Agreement].

17. Shipments through January 8, 1980, equaled 5,510,000 tons of corn and wheat combined. Thus, approximately 2,490,000 tons of these commodities were permitted to be shipped to the U.S.S.R. under license after the embargo was imposed.

1. Structure of the Grain Agreement[18]

In form, the U.S.-U.S.S.R. Grain Agreement is a relatively simple, straightforward document. The agreement provides that the Soviet Union will take delivery of from six to eight million tons of corn and wheat each year (measured from October 1 through September 30) during the five-year life of the agreement.[19] If domestic grain production falls short of a certain level, the United States may reduce the amount covered by the agreement below the six million ton minimum. Conversely, the United States and the U.S.S.R. may agree on levels of supply higher than eight million tons. In fact, for the fourth agreement year (October 1, 1979 - September 30, 1980) the two countries agreed to a supply level of twenty-five million tons, most of which was to have been corn.[20]

It is important to note at this point that while the Grain Agreement is an agreement between nations, no sales are made by the U.S. Government to the Soviet Government. The Grain Agreement provides that purchases will be made through normal commercial channels. Thus, Soviet purchases are made by the Soviet foreign trade organization *Eksportkhleb*[21] directly or indirectly from private grain companies doing business in the United States. The U.S. Government monitors these sales through an export sales reporting system under which exporters are required to report export sales of certain specified commodities.[22]

2. Legal Status of the Grain Agreement

The Grain Agreement is not a treaty. It is merely an executive agreement entered into by the President under his general foreign affairs authority. It has no standing in domestic law, that is, it creates no rights or obligations which are enforceable by either the U.S. Government or a pri-

18. The Grain Agreement came into existence partially as a result of the massive Soviet grain purchases in 1972 which created a good deal of turmoil in the grain markets. The purpose of the Grain Agreement is to guarantee that the Soviet Union will be a steady purchaser of U.S. corn and wheat, and to prevent the Soviets from catching the U.S. grain markets unawares, as they did in 1972. For a more detailed account, *see* Comment, *Evolving U.S.-U.S.S.R. Grain Trading Structure—A Comparison of the 1972 and 1975 Agreements*, 4 SYRACUSE J. INT'L L. & COM. 227-57 (1976).

19. Such agreements are becoming more common. The United States has recently entered into similar agreements with China and Mexico.

20. This may not be technically correct. It is the understanding of the author that during the negotiations on the supply level for the fourth agreement year, the United States informed the Soviets that they could acquire up to 25 million tons of grain from the U.S. market. The Soviets, however, did not formally commit themselves to purchasing this amount. Nevertheless, it appears to have been well understood by both sides that the Soviet Union would purchase this amount, and all involved parties (including the private grain trade) operated on this assumption.

21. For a description of the Soviet foreign trade system, *see* Berman & Bustin, *The Soviet System of Foreign Trade*, 7 LAW & POL'Y INT'L BUS. 987 (1975). *See also* Berman, *Soviet-American Trade in a Legal Perspective*, 5 DEN. J. INT'L L. & POL'Y 217 (1975).

22. *See* Agricultural Trade Act of 1970, 7 U.S.C. § 612(c)(3) (1976). There are a number of ancillary provisions in the Grain Agreement, such as a cross-reference to the U.S.-U.S.S.R. Maritime Agreement, which are not relevant to the subject matter of this article.

vate party. Nevertheless, it is an international agreement which creates rights and obligations under international law between the United States and the Soviet Union. Did, then, the embargo violate the Grain Agreement?

The position of the United States is that the embargo did not violate the Grain Agreement. Article II of the agreement contains the following provision: "During the term of this Agreement, except as otherwise agreed by the Parties, the Government of the USA shall not exercise any discretionary authority available to it under United States law to control exports of wheat and corn purchased for supply to the USSR in accordance with Article I."[23] It is the view of the United States that this provision applies only to the six to eight million ton level specified in Article I. It does not apply to amounts in excess of eight million tons, which are negotiated under Article VI. Therefore, the embargo did not violate the Grain Agreement, since the United States did in fact supply eight million tons of grain to the U.S.S.R. during the fourth year of the agreement.

III. USDA ACTIONS TO OFFSET THE IMPACT OF THE EMBARGO

In his message of January 4, 1980, President Carter directed the Secretary of Agriculture to take all necessary measures to offset any adverse impacts of the embargo on farmers. This directive eventually lead to the implementation of a wide range of actions by the USDA. To understand these actions fully requires a brief description of the grain marketing system.

A. *The Grain Marketing System*

1. *The Physical Flow of Grain*

The flow of grain from the American farmer to the foreign purchaser can easily be traced. Generally speaking, the farmer will harvest the grain and truck it to a country elevator. The country elevator may be operated by a local grain merchant, a farmers' cooperative, or a grain company.

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23. Article I of the Grain Agreement, note 16 *supra*, reads as follows:

> The Government of the USA and the Government of the USSR hereby enter into an Agreement for the purchase and sale of wheat and corn for supply to the USSR. To this end, during the period that this Agreement is in force, except as otherwise agreed by the Parties, (i) the foreign trade organizations of the USSR shall purchase from private commercial sources, for shipment in each twelve month period beginning October 1, 1976, six million metric tons of wheat and corn, in approximately equal proportions, grown in the USA; and (ii) the Government of the USA shall employ its good offices to facilitate and encourage such sales by private commercial sources.
>
> The foreign trade organizations of the USSR may increase this quantity without consultations by up to two million metric tons in any twelve month period, beginning October 1, 1976, unless the Government of the USA determines that the USA has a grain supply of less than 225 million metric tons as defined in Article V.
>
> Purchases/sales of wheat and corn under this Agreement will be made at the market price prevailing for these products at the time of purchase/sale and in accordance with normal commercial terms.

From the country elevator the grain will be transported by rail to a subterminal or terminal elevator. The latter two types of elevators may best be described as regional concentration points in the grain marketing system. Eventually the grain will be transferred by rail or barge (for example, down the Mississippi River) to an export elevator located at a port. The export elevator will then load the grain aboard an ocean vessel for carriage to the foreign destination.

Two important factors should be noted at this point. First, grain is a fungible commodity. From the time it leaves the farmer to the time it is loaded aboard a ship, it is neither earmarked nor identified as being destined for a particular purchaser or as having come from a particular farmer or elevator. Second, as one moves down the marketing chain toward the port of export, the system is more accurately characterized as a pipeline, rather than as a storage system. Thus, an export elevator is strictly a "put-through" facility through which grain from the interior is transferred to ocean vessels. Grain cannot be stored economically at an export location.

2. *The Contractual Flow of Grain*

The contractual flow of grain is considerably more complex. The farmer may sell his grain to the country elevator, in which case he will simply receive a check. On the other hand, the farmer may store his grain at the elevator, in which case he will receive a warehouse receipt. The warehouse receipt is a negotiable document which the farmer may sell at some future date to a grain merchant, broker, or grain company. These "interior" merchants will in turn sell grain to other intermediaries in the grain marketing system. Eventually grain will reach a U.S. exporting firm, which in turn has a sales contract with a foreign purchaser.

This is a highly simplistic description of an extremely complex marketing system. The important point to remember is that with the exception of the farmer and the ultimate foreign purchaser, all of the intermediate actors are "hedging" operations. These actors (grain merchants, brokers, grain companies, exporters, etc.) attempt at all times to maintain an "even" position, that is, to have sales precisely match purchases. A completely "hedged" operation is protected against fluctuations in the market price of a commodity. They make their profits, like all middlemen, by charging their purchasers a slight premium over the cost of the commodity. Generally speaking, these actors make their profits on high volume rather than on high mark-ups or market price fluctuations.

In practice, of course, a middleman is rarely in a precisely even position. There is always a time lag between the time a purchase or sale is made and the time that purchase or sale is "covered" by a corresponding sale or purchase in the market. Also, a covering transaction may not precisely match the transaction it is meant to cover; there may be differences in volume, grade, delivery period, or even type of commodity (the last being known as a "cross-hedge"). To the extent that a middleman is not "even," he is in a speculative "short" or "long" position. A short position occurs when the middleman has more sales than covering purchases. A long position occurs when the converse is true.

B. *USDA Actions*

1. *The Short Term Problem*

The sudden imposition of the U.S.S.R. grain embargo created both short term and long term problems which required immediate attention. The short term problem may be summed up as nothing less than preventing the imminent collapse of the U.S. grain marketing system. This problem was contractual, psychological, and logistical in nature. First, it rapidly became clear that cutting off contracts for approximately 13.8 million tons and expected options of 3.2 million tons of grain would lead to catastrophic losses for the grain export firms.[24] A number of the firms would certainly have gone bankrupt, leaving them unable to honor their contracts with interior suppliers. The collapse of these firms would have sent a tidal wave of losses and bankruptcies back through the marketing chain. To prevent this collapse, USDA stepped into the gap with the contract assumption operation. This operation is described in detail in part IV below.

Second, the problem was psychological in nature because everyone suddenly became aware of the fact that the United States had lost seventeen million tons of export contracts for grain out of a total anticipated export level of 112.9 million tons. The presence of such a large, unexpected surplus, in the absence of USDA action, would have led to a crash in domestic grain prices, with a corresponding ruinous effect upon farmers. To offset this effect, USDA publicly pledged to remove and isolate from the market quantities of grain that were equivalent to the amounts embargoed. Contrary to a misconception that is still held by many,[25] the decision to isolate grain from the market was *not* synonymous with the decision to assume export contracts. The difference will be explained in parts IV and V below.

Third, the problem was logistical in nature because, as discussed above, the U.S. grain marketing system basically operates on a pipeline concept. The imposition of the embargo temporarily clogged the pipeline by suddenly eliminating the Soviet offtake. As a result, many participants in the marketing chain suffered losses due to rail car, barge, and ship demurrage, as well as elevator carrying charges.

The logistical problem might have been largely avoided because, even under the terms of the embargo, there were still over two million tons of grain left to be shipped to the U.S.S.R. This would have given the mar-

24. As was previously stated, the United States and the U.S.S.R. had agreed upon a supply level of 25 million tons for the fourth year of the Grain Agreement. Of this amount, only 21.8 million tons had been contracted for prior to January 7, 1980. However, it was widely anticipated that Soviets would continue to make purchases up to the full 25 million tons.

25. *See, e.g.*, Paarlberg, *supra* note 2, at 147.

keting system pipeline a breathing period in which to adjust to the loss of Soviet exports. Two factors, however, intervened to prevent this from occurring. First, it was necessary to establish an export licensing system in order to permit shipments up to the eight million ton level. Although the Department of Commerce did establish a system and issue export licenses, this of course took some time to accomplish. Second, and more importantly, the International Longshoremen's Association (ILA) announced its own total embargo on shipments to the U.S.S.R.[26] It was not until late February that this problem was really solved through a number of court injunctions against the ILA, and shipments were completed only in April.

In fact, there was very little the USDA or anyone else (except the ILA) could have done to alleviate the physical clogging of the pipeline. The surplus in the pipeline was eventually worked off by the export marketing system.

2. The Long Term Problem

The long term problem was to assure farmers that they would not suffer a disproportionate amount of the losses caused by the embargo. Despite all the actions mentioned above, there was no absolute guarantee to the farmer that prices would not fall. Indeed, many forecasters had predicted falling grain prices before the embargo. At the same time, for reasons totally unrelated to the embargo, farmers were facing rapidly increasing costs. A decline in farm income was inevitable before the embargo, and the contribution of the embargo to this process, if any, is impossible to gauge accurately. A final complicating factor was the presidential election campaign, and the prospect of the politicization of the Soviet grain embargo.

At any rate, immediately after the embargo was imposed, USDA announced a number of steps which were designed to directly benefit farmers. These included raising price support levels and modifying the farmer-held grain reserve to make participation in the reserve more attractive. The latter action did, at the same time, play a significant role in the USDA effort to isolate grain from the market.[27]

IV. THE CONTRACT ASSUMPTION OPERATION

A. *The Decision to Assume the Grain Contracts*

The first question any observer must ask is why it was necessary for the USDA to undertake the contract assumption operation. The second essential question is how the grains and soybean complex differed from other affected agricultural commodities, that is, why the USDA refused to

26. For an interesting discussion of the ILA's role in the grain embargo, *see id.* at 146, 160-61.

27. A variety of actions similar to these, as well as other types of actions, were taken throughout the spring and summer of 1980. The degree to which these actions were related to the embargo is not, in all instances, entirely clear. A detailed discussion of these actions is beyond the scope of this article.

assume contracts for frozen chickens, hog carcasses, meat extenders, etc., which were also cut off by the embargo. The answer to these questions are both factual and legal in nature. Both aspects will be discussed in turn.

1. The Factual Basis for the Decision

The factual basis for the decision was grounded in two overriding factors: (1) the nature of the grain marketing system; and (2) the magnitude of the amount of sales affected. As has been pointed out above, grain exporting companies are hedging operations: they attempt to maintain a relatively even position as between sales and purchases. This was the case on January 4, 1980. On that date total outstanding export sales to all destinations totalled 306 million bushels of wheat (of which fifty-seven percent were Soviet sales), and 917 million bushels of corn (of which forty-nine percent were Soviet sales).[28] Thus, the imposition of the embargo suddenly placed the grain exporting firms in a "long" (purchases exceeding sales) position of about 623 million tons of wheat and corn. As prudent businessmen, the exporters could not have maintained this type of speculative position.[29]

The fact that the exporters were suddenly long 623 million tons of grain does not, however, fully explain the necessity for assuming their contracts. It is also necessary to compare the prices at which those contracts were originally hedged with the prices exporters could have expected to obtain upon selling the 623 million tons of grain.

Most of the Soviet purchases (and, consequently, the corresponding hedging transactions) were made during the summer and fall of 1979. At that time, prices of corn and wheat were significantly higher than in early January 1980. Thus, even putting aside the extreme price depressant effect of 623 million tons of grain being dumped on the market, grain exporting firms would have suffered catastrophic losses if they had been forced to liquidate their long position after January 4.[30]

It was the judgment of USDA officials that such a situation would have had a cataclysmic effect on the U.S. grain marketing system. First, of the fourteen grain exporting firms involved, many of the smaller firms (and even some of the larger ones) could have been bankrupted. These

28. U.S. Dep't of Agriculture, Issue Briefing Paper No. 26: The CCC Assumption of Grain Exporting Contracts 2-3 (July 18, 1980).

29. Also, the legal requirements of the Commodities Futures Trading Commission and the financial requirements of the exporters' banks would have forced the exporters to liquidate their long position.

30. By way of illustration, one should also look at what would happen in the converse situation, *i.e.*, where the hedging price was significantly lower than the market price at the time an embargo was imposed. In that situation (again putting aside the price depressant effect of the embargo) the exporter would be in a position to make huge windfall profits. This would be the case because the exporter would then be holding relatively low-priced purchase contracts while at the same time being able to resell the grain represented by those contracts into a relatively high-priced world market. In the above scenario, a windfall profits tax rather than a contract assumption operation would, arguably, be appropriate.

firms would have been unable to honor their interior contracts, causing a domino effect right back to the farmer. Second, virtually all of these firms would have attempted to liquidate at least a portion of their long position by refusing to honor their interior contracts, claiming *force majeure* as a defense. This too would have swept back through the system like a tidal wave.

To prevent this disaster from occurring, the Government announced on January 7, 1980, that it would assume the contracts affected by the embargo.[31] In return, the exporters agreed to act responsibly by: (1) continuing to honor their interior contracts; (2) not liquidating their "long" position by dumping corn and wheat on the market; and (3) working off the surplus in the pipeline in order to alleviate congestion at the ports and in the transportation system.

2. *The Legal Basis for the Decision*

The contract assumption operation has been described as an "unusual improvisation."[32] It was accomplished through an equally unique governmental entity known as the Commodity Credit Corporation (CCC). In simplest terms, CCC is a wholly owned government corporation designed to finance price support, commodity stabilization, and a wide variety of other agriculturally related programs. It operates within the USDA under the direction of the Secretary of Agriculture.

The existence of the CCC permits the expenditure of money on farm-related programs without the need for specific appropriations or authorizing legislation from Congress. As a technical matter, CCC "borrows" money from the Treasury to carry on its activities. The CCC is then "reimbursed" for its net realized losses through the annual appropriation process. Thus, CCC gives the Secretary of Agriculture a very flexible tool for dealing with unanticipated events such as the embargo. It is extremely unlikely that a successful contract assumption operation could have been undertaken in the absence of a mechanism such as the CCC.

Of course, CCC may only make expenditures for those purposes authorized by the CCC Charter Act.[33] Sections 2 and 5 of the Charter Act set forth a number of general purposes. The contract assumption operation was implemented under the authority of the Charter Act to remove surpluses, to stabilize markets, and to protect farm income.[34] It is important to note that the Charter Act contains no authority to indemnify exporters for losses due to adverse government actions.

In this respect, the legal basis for the contract assumption operation

31. It is not clear whether officials in the White House and USDA were fully cognizant of the necessity for the contract assumption operation *prior to* the imposition of the embargo on January 4. It is clear, however, that the decision to assume the contracts was not made until January 6, 1980, after all the exporters had pleaded their case before high level USDA officials.

32. Paarlberg, *supra* note 2, at 147.

33. Commodity Credit Corporation Charter Act, 15 U.S.C. § 714 (1976).

34. *Id.* §§ 714, 714(b), 714(c).

highlights the critical difference between grains and the other agricultural commodities affected by the embargo. First, the magnitude of the sales of other agricultural commodities in relation to the overall market in those commodities was very small, as compared to the grains situation. It would have been very difficult, if not impossible, to make the factual determinations required by the Charter Act.

Second, the other affected commodities are not traded in the same fashion as grains, soybeans, and soybean products. As has been shown above, it was necessary to assume the grain, soybean, and soybean product contracts because of the potential collapse of the market. This was not the case with the other commodities. Most of those commodities were sold directly from the producer to the Soviet Union. There was no "hedging" of any sort involved. Therefore, even if one could make the factual determinations concerning surpluses, market stabilization, and the protection of farm income, there would be no justification for purchasing the commodities in question only from the adversely affected exporter at the Soviet contract price and specifications, as opposed to purchases in the open market at market prices. In reality, this would simply have been an indemnification operation rather than a surplus removal operation, and as mentioned above, there is no authority for such an operation in the CCC Charter Act.

B. The CCC-Exporter Agreement

1. Negotiation of the Agreement

The CCC-Exporter Agreement was the product of four weeks of intensive negotiation between the exporters and the USDA.[35] The contents of the agreement were finalized in early February 1980, and the agreement was signed by twelve of the fourteen companies affected.[36]

After the decision to assume the contracts had been made, the Secretary of Agriculture appointed the General Counsel of USDA to conduct negotiations with the exporters in order to develop an agreement under which USDA would assume the contracts. A task force was formed within the Department to formulate the USDA position, to draft a proposed agreement, and to negotiate that proposal with the exporters.

An initial draft of the agreement was presented to the exporters during the week of January 15, 1980. After two general meetings between the exporters and USDA during the following week, it was generally agreed that the essential terms of a workable agreement had been developed. An informal committee of five persons,[37] was then appointed by the exporters

35. In reality, there are two agreements. The CCC-Exporter Agreement covers wheat, corn, and soybeans. The CCC Soybean Meal and Oil Agreement covers soybean products. The latter agreement was negotiated after the first, and contains substantially similar general terms. The second agreement was necessitated by the fact that soybean meal and oil are not traded on the same basic contract terms as wheat, corn, and soybeans.

36. The formal offer of the CCC to the affected exporters expired on February 15, 1980. Three firms signed the CCC Soybean Meal and Oil Agreement later that spring.

37. The five members of this informal committee were drawn from the four major ex-

to work out the final, more minor details of the agreement with USDA. Thus, by the end of January the agreement had essentially reached its final form.

2. *Term of the Agreement*

It is beyond the scope of this article to describe in detail every provision of the CCC-Exporter Agreement. Nevertheless, it should prove useful to describe the general thrust of the agreement, certain of its key provisions, and how it was meant to operate.

a. *Structure of the Agreement*

The general objective of the agreement was to provide a framework by which CCC could acquire from the exporters the contract rights to receive delivery of grain which otherwise would have been shipped to the Soviet Union, and eventually retender those same contract rights back into the export market. It is important to note at this point that the subject matter of the agreement is contract rights to receive delivery of grain at a certain port range during a certain period of time (for example, "50,000 tons No. 3 yellow corn, Gulf ports, May delivery"). Such rights are commonly traded between both exporters and overseas purchasers. Thus, the subject matter of the agreement did not refer to actual, physical stocks of grain.[38]

The typical contract for the exportation of grain from the United States is the North American Export Grain Association No. 2 F.O.B. Contract (NAEGA 2). In assuming these contract rights, CCC in effect acquired a massive inventory of basically similar contract rights to receive delivery of grain at a variety of port ranges[39] for a variety of delivery periods.

Despite the fact that these contract rights were basically similar, some important differences did exist between the various exporters and even between individual contracts made by the same exporter. The CCC-Exporter Agreement standardized these contracts by converting them to a single, uniform basis.[40] Price adjustments were made to reflect changes in the original terms of the contract.

The second important objective of the agreement was to establish a number of special provisions outside the NAEGA 2 framework that would

porters (Cargill, Bunge, Louis-Dreyfus, and Continental) and one smaller company (Tidewater Grain).

38. This distinction is legally important because of various statutory restrictions on the sale of stacks of grain held by CCC. *See* 7 U.S.C. §§ 1445(e), 1427 (Supp. I 1979). These restrictions prohibit the sale of commodities held by CCC at prices which are below a certain minimum. The contract assumption operation could not have been successfully implemented if these restrictions also applied to contract rights, since the retendering of the contract rights was an integral part of the operation.

39. The four basic port ranges are Atlantic, Gulf, Lakes, and Pacific.

40. This was accomplished by incorporating in each individual exporter's agreement a schedule containing the essential terms of the exporter's contracts with the purchaser for shipment to the U.S.S.R.

govern the mutual obligations between the exporters and the CCC. These provisions included certain certifications by the exporter, a profit deduction, a short position deduction, and a rollover provision. These provisions will be discussed below.

b. Specific Provisions of the Agreement

i. Force Majeure Certification

Several specific provisions of the CCC-Exporter Agreement deserve special attention. The first of these is the certification by the exporter that it will honor its interior contracts, notwithstanding the imposition of the embargo or the boycott actions of the ILA.[41] In effect, the exporter waived any right to assert a *force majeure* defense against interior suppliers. This waiver, from the point of view of USDA, was the primary *quid pro quo* of the agreement.

ii. Profit Deduction

Another important provision of the agreement is the profit deduction. Under the terms of the agreement, the contract price between CCC and the exporter is the Soviet contract price (plus or minus an adjustment for standardization of terms) less an undetermined deduction for profit and short position.[42] When settling a contract under the agreement, therefore, CCC initially makes payment of only ninety-seven percent of the Soviet contract price to the exporter.[43] The final three percent is withheld pending the determination of an appropriate deduction from the Soviet contract price for profit and short position.

The profit deduction was included at the insistence of USDA. The real problem, however, was how to formulate a workable method of determining an appropriate deduction. First, it was clear that there was no way of calculating a profit on the Soviet sales alone. It is impossible to extract these sales and corresponding hedges from the overall sales and hedging operations of all but the smallest exporters.

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41. This provision (Section II(C), reads as follows:

C. The Exporter certifies that it and its affiliates have not breached or failed to perform, and will not at any time in the future breach or fail to perform, any obligation to third parties (exclusive of the original purchasers, in their capacities as purchasers, under the eligible contracts) in the U.S. agricultural and transportation industries (including but not limited to farmers, warehousemen, elevator operators, and transport operators) on the grounds that such obligation has been modified, terminated, rescinded, excused, or nullified by: (1) the imposition of restrictions on the exportation of agricultural commodities by the President on January 4, 1980, and as implemented by the regulations issued on January 7, 1980, at 45 FR 1883, and as may later be amended; or (2) the refusal of the International Longshoremen's Association to handle cargo destined for the USSR. Nothing in this paragraph shall preclude the Exporter and its affiliates from entering into modifications, by mutual consent, of the terms and conditions of existing contracts with third parties in the U.S. agricultural and transportation industries.

42. *Id.* § III(B)(1).

43. *Id.* § II(B)(3). Under NAEGA 2, payment does not occur until delivery of the commodity is made. Thus, provisional payments continued to be made through February 1981.

Second, it rapidly became clear that there was no way to define "profit" in a single document that would be applicable to all exporters. Moreover, the urgency of concluding an agreement would not have permitted the negotiation of a separate provision for each exporter.

To solve this dilemma, the exporters and USDA agreed to establish an independent board of accountants. One member of the board was appointed by the exporters, one by USDA, and one by the American Institute of Certified Public Accountants. The board was charged with developing standards and procedures for determining the profit margin for each exporter. Applying these standards, both the exporter and USDA auditors were to determine a profit margin for the exporter. If there was any disagreement between the two figures, USDA and the exporter would attempt to negotiate a mutually acceptable figure. If they were unable to do so, the dispute would be presented to the board for resolution.

iii. Short Position Deduction[44]

Theoretically, to the extent that an exporter was "short" on January 4, 1980, the imposition of the embargo did not have an adverse effect on that particular exporter. In other words, the "short" position could absorb some of the "long" position that was created by the imposition of the embargo. Therefore, if CCC assumed all of the affected contracts, exporters who were short on January 4, 1980, would remain short. They could then move into a falling market (falling as a result of the embargo) and garner undeserved windfall profits because of the decline in the market.

From a practical point of view, however, the fact that a particular exporter was short on January 4, 1980, would have had very little to do with whether a high-priced Soviet contract had been covered by a comparably high-priced hedge several months earlier. An exporter might have been "long" or "even" during all of 1979 and still have been short on January 4, 1980, for reasons totally unrelated to its Soviet sales (for example, a sale made that day to Japan or the EEC). This problem was resolved by providing for a short position deduction based on the smallest amount by which the exporter was short between the date of the exporter's last Soviet sale and January 4, 1980. The amount of any such short position would be pro-rated to the exporter's Soviet business and then converted to a monetary deduction from the Soviet contract price.

iv. Rollover Provision[45]

The rollover differential is the cost of changing a delivery period on a

44. *Id.* § III(B)(2).

45. This provision of the Agreement (Section III(B)(5), reads as follows:

(5) CCC may, at its option, change the delivery period in any given contract or a portion thereof to a later period of its choice, but no later than March 31, 1981. If CCC exercises this option, the contract price shall be increased or decreased by the amount of the market differentials for the later delivery period as of the date of the exercise of the option. However, for delivery periods beginning prior to March 1, 1980, the relevant market differentials (cents per bushel) shall be:

contract. Generally speaking, the longer a delivery is deferred, the greater the differential. The rollover differential is treated as an adjustment in the contract price.

It was clear from the outset of the negotiations on the CCC-Exporter Agreement that it would be impossible for USDA to begin immediately to liquidate the contract rights it was about to acquire. It was therefore necessary to "roll over" contract delivery dates from earlier months to later months. The agreement provided for rollovers through June 1980 at specified differentials. Rollovers into later months were based on market price differentials in existence at the time the rollover option was exercised by USDA.[46]

C. Retendering of Contract Rights

With the exception of calculating the appropriate profit and short position deductions, the contract assumption operation was basically completed with the successful retendering of the contract rights back into the export market. Beginning in late March, USDA held tenders twice weekly for each commodity in which it accepted bids on its inventory of contract rights. Bids were accepted or rejected based on an evaluation of current market prices and conditions. The retendering process was completed in midsummer 1980. Delivery of grain on the retendered contracts continued through February 1981. Consequently, payments to exporters (as well as payments to USDA from the purchasers of the contract rights) continued through that date.

Original Period	Later Period			
	March, 1980	April, 1980	May, 1980	June, 1980
	Corn	Corn	Corn	Corn
December, 1979	20	27½	30¼	38
January, 1980	20	27½	30¼	38
February, 1980	10	17½	20	27½
	Wheat	Wheat	Wheat	Wheat
December, 1979	6¼	16½	18¼	21½
January, 1980	6¼	16½	18¼	21½
February, 1980	2½	11¾	14¾	15½
	Soybeans	Soybeans	Soybeans	Soybeans
December, 1979	18	30	39¼	56½
January, 1980	18	30	39¼	56½
February, 1980	8¼	21¼	27¾	43¾

CCC shall give notice to the Exporter that it is exercising its option under this provision not less than 30 days before the beginning of the original delivery period, or not more than 30 days after the signing of this Agreement, whichever is later.

The differentials given in the schedule above were based on the differentials as they existed on January 4, 1980.

46. The total rollover cost was approximately $170 million.

V. REMOVAL OF SURPLUS COMMODITIES

The contract assumption operation was not in and of itself a surplus removal operation. Indeed, attempting to take delivery on export contracts would have added another layer of complexity to an already difficult situation. Delivery could not be accomplished at export locations since these elevators are not storage facilities. Conversion of the contracts to interior delivery, where storage was available, would have required incredibly complex and time-consuming negotiations.

The surplus removal aspect of the operation was accomplished by direct USDA purchases of wheat and corn and by entry of corn into the farmer-held reserve.[47] By the end of April 1980, USDA had purchased 4.1 million tons of wheat.[48] Also, by midsummer, USDA had purchased 4.1 million tons of corn and farmers had placed 7.2 million tons into the farmer-held reserve. These figures are clearly in excess of the amounts of wheat and corn that were affected by the embargo. The figures are even more impressive when it is considered that total U.S. exports of wheat and corn actually declined very slightly from the levels that were forecast prior to the embargo, and were much higher (by volume) than during the previous year.

VI. OBSERVATIONS AND CONCLUSIONS

The grain embargo of 1980 vividly demonstrated how the use of export controls can be a two-edged sword. In attempting to influence Soviet behavior, the President placed the entire U.S. grain marketing system into an extremely precarious position overnight. A collapse of the system was only averted through the swift and prudent actions of administration officials and the grain exporting firms. One can only speculate as to what might have happened had some exporters panicked, or had the Government reacted less quickly to the needs of the moment.

From a strictly operational point of view, the contract assumption operation can probably be described as extremely successful, despite the fact that CCC lost over $450 million in the process.[49] The CCC-Exporter Agreement did achieve its immediate goal of preventing the collapse of the market. It was negotiated over a very short period of time, and was implemented without any major difficulties. Almost overnight, USDA acquired contract rights to receive 8.9 million tons of corn, 4.3 million tons

47. The farmer-held reserve is a mechanism by which farmers agree to hold a commodity off the market until prices reach certain predetermined levels. In return, the farmer receives a non-recourse price support loan, which is practically interest free, as well as storage payments. *See* 7 U.S.C. § 1445(e) (Supp. I 1979).

48. Under the authority of a statute recently passed by Congress, the wheat will be placed into an international emergency reserve for use in food aid programs during times of short supply or to meet urgent humanitarian needs of an unanticipated nature. Food Security Wheat Reserve Act of 1980, Pub. L. No. 96-494, 94 Stat. 2578 (1980).

49. The total value (Soviet price) of the contract rights acquired by the USDA was $2.4 billion. Counting rollover costs, it is anticipated that total CCC losses will be around $460 million.

of wheat, 710,318 tons of soybeans, 400,000 tons of soybean meal, and 30,000 tons of soybean oil, and within seven months had retendered these contracts back into the export market without adversely affecting the market.

Nevertheless, when the danger to the United States grain marketing system and the eventual costs to the Government are considered, it must seriously be questioned whether food exports really do constitute, because of domestic considerations, a potentially effective and credible foreign policy tool. Indeed, one might argue that food exports, rather than a foreign policy tool, are a foreign policy *liability* because of the dependence of the agricultural sector of the domestic economy on such exports. In this respect, the essential lesson of the grain embargo may be that as the United States becomes more economically interdependent with the rest of the world, its ability to take unilateral actions such as grain embargoes is correspondingly diminished. To a certain extent, the United States is in need of Soviet purchases just as much as the Soviets are in need of U.S. grain. Thus, the concept of food as a weapon may be largely illusory.

Moreover, even if the economic ramifications of an embargo can be managed, it is not at all clear that the political and psychological impacts of an embargo on agricultural commodities can likewise be contained. Rightly or wrongly, many farmers view such embargoes as an unfair and ineffective method of attempting to influence the behavior of foreign countries.

It is not surprising, therefore, that this issue has extremely complex political overtones. The embargo was clearly a significant issue in a number of states during the 1980 presidential campaign. Predictably, a number of bills were introduced in the present session of Congress either to end the embargo (which is now a moot point) or to restrict the freedom of the President to impose embargoes on agricultural commodities in the future.[50] In addition, it can be argued that the debate over the embargo detracted from the consideration of other major farm policy questions.[51]

At the same time, President Reagan, who during the 1980 campaign expressed a desire to lift the embargo, was unable to do so immediately because of the crisis in Poland.[52] This also demonstrated an important aspect of the use of embargoes in general. They are an easily identifiable and highly visible type of foreign policy action. The lifting of an embargo, as well as its imposition, may therefore have very significant foreign pol-

50. In the 97th Congress, 1st Session, *see, e.g.*, S. Res. 63, S. 355, H.R. 2233, and H.R. 2243 (1981).

51. Several important provisions of major farm statutes expire at the end of the 1981 crop year. Consequently, Congress is now actively considering various proposals for inclusion in the 1981 omnibus farm bill.

52. President Reagan initially refused to lift the embargo because he felt that it would be sending the "wrong signal" to the Soviet Union during the Polish crisis. *See* Wash. Post, Apr. 18, 1981, at 1, col. 5. The President did, however, lift the embargo on April 24, 1981. *See* Wash. Post, Apr. 25, 1981, at 1, col. 5.

icy and domestic political ramifications. In this respect, embargoes can be a relatively inflexible foreign policy tool.

This is not to say that the imposition of export controls on agricultural commodities can never be utilized as a foreign policy tool or as a means of strengthening national security by deterring aggression by other countries. The grain embargo of 1980 does demonstrate, however, that such actions have extremely important domestic ramifications which must be weighed more carefully in the future against the objectives and probability of success.