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# Agricultural Trade Policy Under Scrutiny

Seven Papers Based on Presentations  
at the Televideo Conference  
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# Agricultural Trade Policy Under Scrutiny

## Foreword

R. Bruce Mackey and Michael V. Martin<sup>1</sup>

As much as or more than other areas the Pacific Northwest is tied to the global economy. Oregon is particularly affected by economic relations with the Asian Pacific Rim. Contrary to belief, international trade does not now comprise the major share of Oregon's economic activity, but it is the growth area for many of Oregon's leading industries. Pacific Rim markets are a major driving force for Oregon's agricultural and forestry industries. The state's reliance on trade will certainly continue to grow. And it is widely believed that recovery in Oregon's economy depends on success in revitalizing international trade.

Obviously, trade is extremely important and benefits Oregonians. But, trade is not without unpleasant side effects. This publication discusses some of the gains from trade and some of the problems from trade. It is based upon a televideo conference, "Agricultural Trade Policy Under Scrutiny," produced by Earl Brown from the University of Maryland and Luther Tweeten from Oklahoma State University on March 19, 1985. It focuses on U.S. trade policies and addresses many questions that directly affect Oregon agriculture, such as:

- Should we put up trade barriers or encourage free trade?
- Should we subsidize exports or seek to organize a grain cartel?
- Should price supports be allowed to go above world prices?
- How does the national debt affect our trading ability?
- Should trade embargos be used as a political tool?

As Oregonians we need to understand our comparative advantages (or disadvantages) as we expand our trading borders. Further, our policies and diplomatic ties will greatly affect our ability to attract new trading partners and sustain stable economic relationships over time.

Oregon and PNW are unique in their reliance on international trade. The region is geographically located on the Pacific Rim with access to some of the world's most dynamic economies. Japan is our primary trading partner and accounts for over half the total trade from Oregon ports. With a few minor exceptions all of the trading partners are on the Pacific Rim. Table 1 shows the 1983 trade value by country. Japan, Singapore, and Hong Kong are nations with developed economies highly reliant on trade. South Korea, Taiwan, Thailand, Malaysia, and the People's Republic of China are pursuing export-led economic development with some success. These are all important or potentially important U.S. trading partners.

A significant share of trade with these economies originates, terminates, or passes through Oregon and the Northwest. Moreover, the Asian Pacific Rim is expected to be the leading growth region for U.S. trade in the next several decades. These are certain to be the

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<sup>1</sup>Extension economist and associate professor, respectively, Department of Agricultural and Resource Economics, Oregon State University.

Table 1.

Oregon Ports  
Leading Trading Partners, 1983<sup>1</sup>

Country	Oregon exports (in dollars)	Oregon imports (in dollars)	Total Trade (in dollars)	Percent of total
Japan	\$1,613,127,244	\$1,698,843,208	\$3,311,970,452	50.6
Republic of Korea	412,238,095	171,893,029	584,131,124	8.9
Taiwan	192,546,726	104,623,611	297,170,337	4.5
Australia	90,394,529	185,240,083	275,634,612	4.5
India	244,903,242	2,758,869	247,662,111	3.8
West Germany	18,533,499	191,438,017	209,971,516	3.2
Philippines	150,910,572	48,776,062	199,686,634	3.1
Indonesia	141,877,922	3,918,169	145,806,091	2.2
Egypt	126,416,266	0	126,416,266	1.9
People's Republic of China	89,358,901	15,734,080	105,092,981	1.7
United Kingdom	42,159,689	40,156,669	82,316,358	1.3
Malaysia	43,960,039	34,145,939	78,105,978	1.2
Italy	62,814,468	11,154,753	73,969,221	1.1
Sweden	4,882,399	69,170,473	72,052,872	1.1
Canada	29,435,914	39,951,704	69,387,618	1.1
Hong Kong	25,490,826	25,156,686	50,647,512	0.8
Netherlands	28,313,739	20,324,910	48,638,649	0.7
Yemen (South)	47,989,607	0	47,989,607	0.7
Jamaica	0	42,221,193	46,221,193	0.7
France	13,346,704	28,651,387	41,998,091	0.7
Total	\$3,378,710,381	\$2,736,158,842	\$6,114,869,223	93.4
Other Countries	320,194,081	109,196,348	429,390,366	6.6
Total Trade	\$3,698,904,399	\$2,845,355,190	\$6,544,259,589	

1 Economic Trends Oregon and the Nation 1950-1984, First Interstate Bank of Oregon, N.A., Economic Research Report, June 1985.

drawing force markets for a number of Oregon and PNW industries (including agriculture, forestry, and fisheries) for many years.

The significance of the Pacific Rim trade is made more pronounced when one realizes domestic markets are distant to Oregon producers. The domestic population shift from the east to the south and southwest makes it difficult for many industries to serve population growth centers. The PNW's transport system was largely designed for west to east service, but the eastern markets more effectively served are no longer growing rapidly. In any case, domestic markets for many PNW products hold limited prospects for significant growth. Efficiency dictates that we look to the west for new opportunities.

Oregon ports handle about \$6 billion in total international trade in recent years (Table 1). Interestingly, there is little information on how much of that trade comes from Oregon. As an example, the total wheat exports for 1983 are almost \$1.8 billion; the total value of wheat produced on Oregon farms for the same year was \$235 million (about 13 percent of the total) but we do not know what portion of Oregon wheat was exported. Oregon Port exports generally indicate the types of things Oregon contributes to international trade.

Oregon's leading exports are primarily forest and agricultural (wheat) products. The leading imports seem to be labor-intensive manufactured products (Table 2).

Fortunately, the products which can be produced best in Oregon and the PNW are likely to be needed in many Pacific Rim nations. Countries like Japan, South Korea, Taiwan, Singapore, and Hong Kong have a very limited ability to produce for themselves products which require an abundant supply of natural resource inputs. The entire PNW region is endowed with natural resources that nicely match the needs of many of our trading partners.

Likewise, the PNW's geographic setting provides the opportunity to build industries to complement the manufactured product imports from Asian Pacific Rim countries. Handling, assembly, and final fabrication industries can spring off the availability of imported manufacture or semi-manufactured inputs. Note, for example, that Portland and Seattle are primary import centers for Japanese cars. Recently, South Korea began shipping cars to Portland.

Beyond the direct economic advantages of trade, economic relations provide cultural ties which, if cultivated intelligently lay the groundwork for future enhancement of the State's economy. Trade tends to increase mutual dependence and strengthen diplomatic ties. In turn, diplomatic ties tend to encourage trade. In either case, economic interest reduces the prospects for conflict. For example, as trade with the People's Republic of China increases, our two countries have found new reasons to avoid confrontation over other issues.

This publication should help us understand the dynamics of international trade which will continue to grow in economic importance to the U.S. and, more so, to the PNW and Oregon.

Table 2.

Major Exports and Imports<sup>1</sup>  
Through Columbia River Ports, 1983

Commodity	Dollar value	Percent of total
<u>Exports</u>		
<u>Total Exports</u>	\$3,698,904,399	100.0
1. Wheat	1,763,218,476	47.7
2. Logs	312,090,066	8.4
3. Lumber	195,037,428	5.3
4. Yellow Corn	150,937,321	4.1
5. Barley, including malting barley	118,640,331	3.2
6. Wood Chips	113,766,831	3.1
7. Kraft Paper Products & Milk Carton Stock	106,386,783	2.9
8. U.S. Standard Newsprint	87,448,130	2.4
9. Aluminum	80,625,821	2.2
10. Plywood and Veneers	67,808,456	1.8
11. Other	702,944,756	19.0
<u>Imports</u>		
<u>Total Imports</u>	\$2,845,355,190	100.0
1. Automobiles & Trucks	1,542,589,319	54.2
2. Aluminum Oxide (Alumina)	236,790,567	8.3
3. Footwear	115,224,238	4.0
4. Steel Plates and Sheets	62,633,675	2.2
5. Agricultural Tractors and Forklift Trucks	55,642,601	2.0
6. Tires and Tubes	49,092,743	1.7
7. TV's, Radios and Related Equipment	44,560,740	1.6
8. Petroleum Products	42,394,695	1.5
9. Measuring, Testing and Control Instruments	41,672,877	1.5
10. Steel Pipe, Fittings, Flanges Couplings	28,118,704	1.0
11. Other	626,635,031	22.0

<sup>1</sup> Economic Trends Oregon and the Nation 1950-1984, First Interstate Bank of Oregon N.A., Economic Research Dept., June 1985.

# Agricultural Trade Policy Under Scrutiny An Overview

## Ag Trade 1

**C. Parr Rosson, III<sup>1</sup>**

International trade is in the forefront of discussions on economic growth and development. Trade is critical to the vitality of American agriculture. Most analysts expected trade to carry agriculture full force into the 21st century, but this will not occur. Some have blamed this failure on the lack of unified domestic and trade policy goals. Others have declared there is too much government intervention in agriculture. Whatever the cause, the complex problems facing agriculture today require that everyone be informed.

The objectives of this leaflet are to discuss the importance of trade to agriculture, highlight present trade policy issues facing American agriculture, present some alternative solutions to problems found when formulating trade policy, and inform people about key issues facing agriculture today and the broad implications some of these issues may have. These issues were considered at a recent televideo conference on agricultural trade policy.

## U.S. Agriculture and the International Market

During the 1970's, the American farmer was thrust into the global agricultural economy when world demand for food rapidly expanded. The value of American agricultural exports increased from \$8 billion in 1972 to \$38 billion in 1984.

Almost two-thirds of this increase occurred because of higher prices. The rest resulted from increased tonnage that expanded from 67 million tons in 1972 to 144 million tons in 1984. Although the United States exports a wide variety of agricultural products, wheat, corn and soybeans accounted for 79 percent of the total volume in 1984.

The United States' share of the world's grain trade declined from 53 percent in 1975 to 43 percent in 1984. Recently, America exported about one-half of its wheat and soybean crops and one-fourth of its

coarse grain crops. These figures represent a major share of the world export market. In 1983, the United States accounted for 60 percent of the world soybean market, 40 percent of the world wheat market and 50 percent of the world market for coarse grains.

Japan is the largest single market for U.S. agricultural exports, with sales reaching \$6.9 billion in 1984. Other important markets include: the European Community, Soviet Union, Mexico, China, Korea, Hong Kong and Taiwan.

Developed countries purchase about half of all American agricultural exports, compared to two-thirds in 1970. Developing countries account for almost 40 percent compared to 29 percent in 1970. Centrally planned economies have more than doubled their share. These developments have exposed American agriculture to the risks and uncertainty of dealing with the Third World.

Exports account for 25 percent of all farm cash receipts, down from a record 30 percent in 1980. Agriculture generates a trade surplus of \$18 to 20 billion annually, offsetting the nonagricultural trade deficit by almost one-fifth.

Farm prices are related closely to the health of agricultural exports. When exports increased in the 1970's, farm prices followed. When exports declined, so did farm prices.

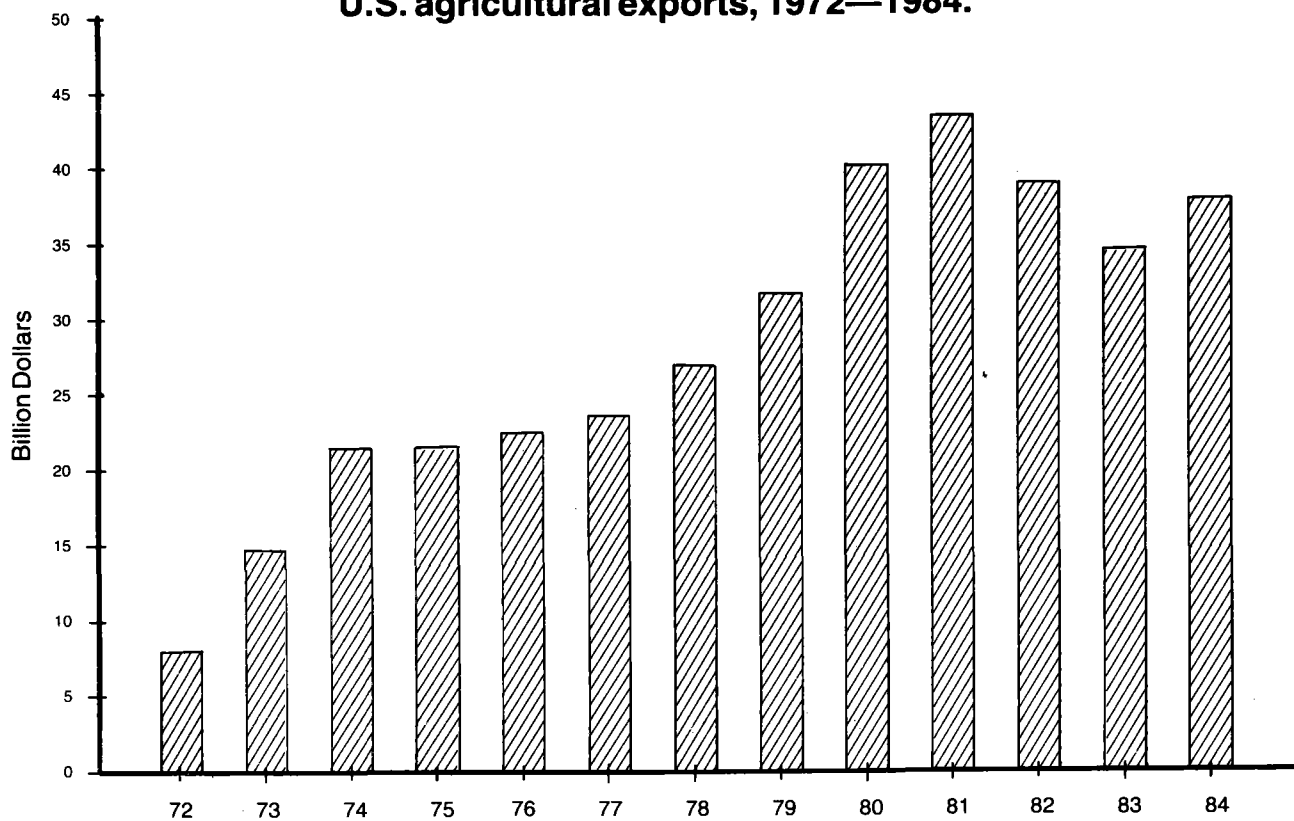
Two important policy decisions made in the early 1970's led to the export boom. First, farm policy became more market oriented, allowing changes in world supply and demand conditions to determine prices. Second, dollar devaluations in 1971 and 1973 effectively reduced the prices of American agricultural products. In addition, U.S. agricultural exports responded to increasing incomes worldwide, easy export credit to developing countries and the emergence of the Soviet Union and China as major food importers.

Since 1981, exports have declined substantially. Farm prices and incomes reached depression lows, while stocks increased. Reasons for this dramatic shift in exports are many. They include global recession, a stronger dollar, the grain embargo against the Soviet Union, restrictive trade practices by the United States and other countries and an inflexible farm policy that kept crop loan rates above market clearing levels. The overall result has been a decline in the American share of world agricultural exports.

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<sup>1</sup>Extension agricultural economist, Clemson University, Clemson, South Carolina

**Value of  
U.S. agricultural exports, 1972—1984.**

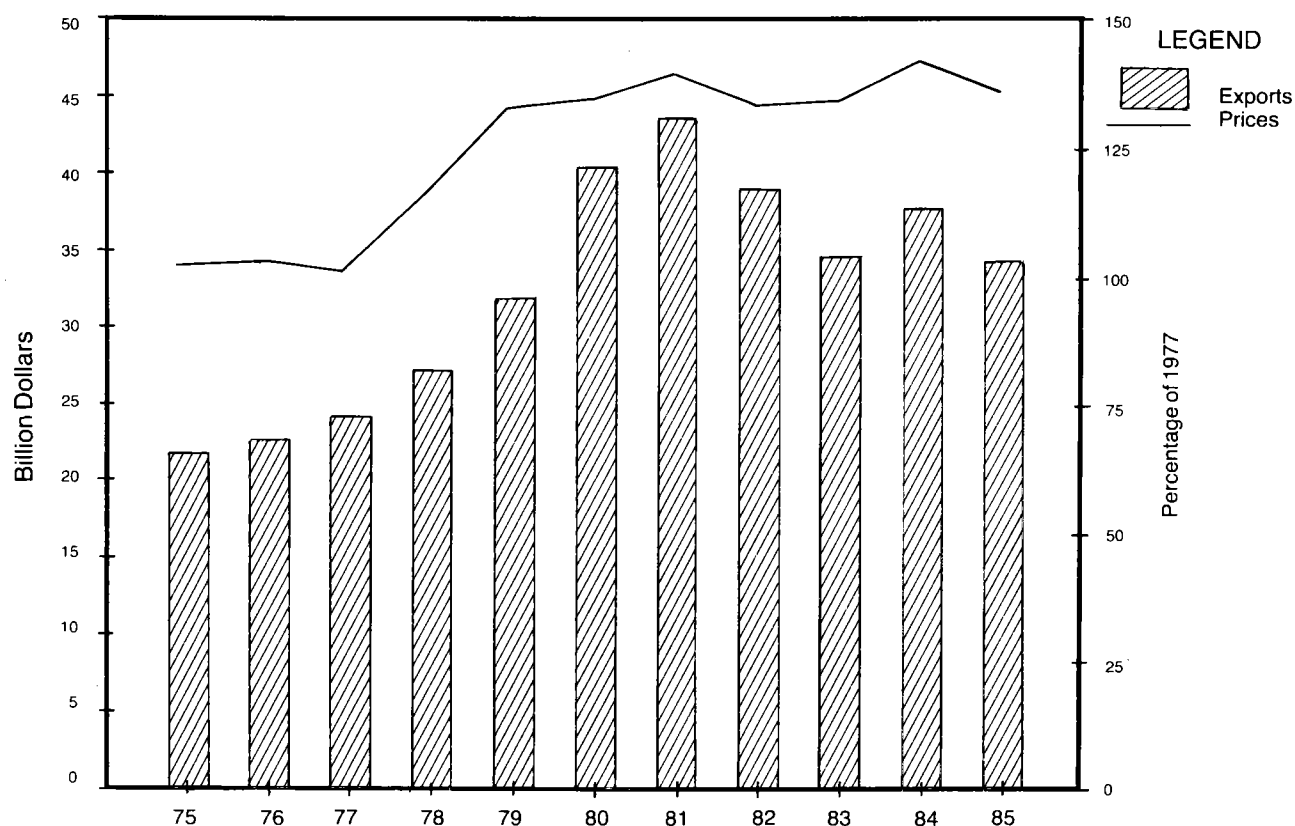


**Volume of  
U.S. agricultural exports, 1972—1984.**

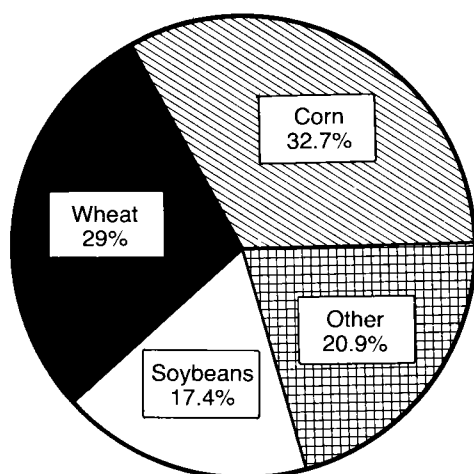




## U.S. agricultural exports and farm prices fiscal years 1975—1985.



**Commodity shares of U.S. agricultural exports  
by volume, fiscal year 1984.**



Source: USDA, ERS FAS "Outlook for U.S. Agricultural Exports," December 3, 1984.

## Linkages Between U.S. Economic Policies and Agricultural Trade

Comments by Robert Chambers, of The University of Maryland, emphasize the relationship between the increasing value of the dollar and declining exports. In addition, at the televideo conference, he cited three other problems that have hampered export recovery. First, much of the Third World still is experiencing debt repayment problems and austerity programs that limit their ability to import. Second, American exports often face severe and unfair competition on the world market. Finally, the sluggish economic recovery of many U.S. trading partners has reduced their ability to import food products.

It was pointed out that eliminating the national deficit and loosening credit would be short-term solutions to a multifaceted problem. Dr. Chambers' remarks ended on a positive note. "In the long term, U.S. agriculture will remain the most efficient ... food producing machine in the world." However, Dr. Chambers said that many farmers would suffer in the interim.

D. Gale Johnson, University of Chicago, believed a \$100 billion deficit could be sustained almost indefinitely. Luther Tweeten, Oklahoma State University, indicated that a balanced Federal budget would reduce the real cost of borrowing by 4 percent. This would result in a 20 percent decline in the value of the dollar and a 20 percent increase in agricultural exports. Also, he noted that farmers have a major stake in getting the Federal fiscal house in order.

## Strategies for Expanding Farm Exports

Leo Mayer, Foreign Agricultural Service — U.S. Department of Agriculture, emphasized the importance of expanding exports to the overall health of U.S. agriculture. He noted that American agricultural exports probably will not return to 1970's levels, at least not in the near future. Although the strong dollar has hampered all exports, soybean exports to Europe have been particularly damaged, falling 25 percent since 1983. In other areas Dr. Mayer indicated that the dollar's effect probably has been overstated.

Dr. Mayer said domestic farm policy was probably the major contributor to the decrease in agricultural exports. Several times during the last few years world market prices fell below U.S. loan rates for supported commodities. When this happened, farmers "sold" their crops to our government rather than to other countries. He said that reducing these loan rates is a major objective of the current administration in the 1985 farm bill.

In addition to reducing loan rates, Dr. Mayer said the United States should take the following steps to increase agricultural exports.

1. Reduce the Federal deficit, which should result in a lower-valued dollar.
2. Negotiate lower trade barriers.
3. Expand PL 480.
4. Expand the use of blended credit and other similar programs.

The European Community (EC) agricultural representative, Bruno Julian, said that although EC has become a major exporter of some agricultural products, it also is a major importer. EC had a \$15 billion agricultural trade deficit in 1984. Mr. Julian said EC believes it is entitled to a fair share of the world market, and that it will be aggressive in trying to obtain this share. However, he said, it would observe the terms and rules of the General Agreement on Tariffs and Trade (GATT).

Mr. Julian acknowledged that EC supported the price of several agricultural commodities above world market levels, but he said that the United States also subsidizes its agriculture. EC and U.S. goals for agriculture are similar, according to Mr. Julian. The major difference is how they achieve these goals. The number of EC farmers has decreased from about 20 million to 6 million over the last 20 years and even with this reduced number,

production exceeds demand. The surplus is exported at subsidized prices. EC is taking several steps to curb production, according to Mr. Julian. Primarily it wants to bring EC prices and world prices closer together.

Ken Bader, Chief Executive Officer, American Soybean Association, spoke about his concern for the decrease in the market share of soybeans, from 70 to 75 percent a few years ago to about 60 percent now. He said it is extremely difficult to compete, and listed the following reasons why:

1. the increased value of the dollar, which he blamed mainly on the U.S. budget deficit;
2. governmental policies in Brazil and Argentina where farm prices of soybeans are kept low, currently around \$4 per bushel, and export prices are set just below U.S. prices;
3. worldwide economic recession that reduced demand for meat and, in turn, reduced demand for U.S. soybeans; and
4. increased production of feed wheat in other countries.

Dr. Bader stressed the importance of market development as a way to increase agricultural exports. He said that market development is a total package. It is being visible, promoting the crop and having supportive trade and economic policies.

## Background for Trade Policy

David Blandford, Cornell University, discussed the consequences of protection. He identified protection as a set of policies that insulate industry from the international market and competition. Taxes, subsidies or other restrictions of trade are used most often. Specifically, levies, quotas, tariffs, trading procedures or standards, state trading, and subsidies in production, marketing or consumption are measures used to restrict trade.

Recent evidence from the International Monetary Fund (IMF) suggests that trade restrictions among developed countries are fairly prevalent. Poorer countries, however, restrict trade as well.

Why does this occur? A primary reason is to ensure national security through the protection of strategic industries. Social policy may dictate the protection of farm income and market stability as major goals. Employment and the balance of payments also can be effectively protected through trade restrictions. Many times protective measures have been used to retaliate for the unfair trading practices of other countries.

The major economic effects of restricting trade include higher consumer prices, a subsidy to the protected industry and lower prices for exporters. The consumer and foreign exporter share the burden of paying for the trade restriction.

Finally, it is important to remember that adjustment for protection toward a more open market environment can be a costly process. Resources employed in the protected industry, mainly labor, will be displaced. Retraining and relocation expenses

will probably be high. Therefore, it may be necessary for those who gain from a reduction of protection (consumers) to compensate those who lose (industry and workers).

## Formulating a Coherent Trade Policy

Trade policy can be defined as a set of principles, laws and institutions designed to increase benefits to American producers and consumers from trade. Disagreement regarding trade policy is widespread. Some critics say the United States has no agricultural trade policy. Others say no policy is the best policy. Although most observers would agree that the United States has several policies that affect agricultural trade, no coherent agricultural trade policy exists. Formulating a coherent agricultural trade policy should include a discussion of these questions.

- Should a cabinet-level Department of International Trade be established, consolidating the fragmented activities now being performed by various governmental departments and the Office of U.S. Trade Representative?
- Would American farmers and consumers be served better if all grain exports were handled by one government grain board rather than by several private exporting firms?
- Should the United States actively seek arrangements with other countries to control prices and trade to stabilize markets?
- Will the United States have success in negotiating reductions in trade barriers for agricultural exports only if it is willing to negotiate lowering or removing barriers to farm commodity imports into America?
- Would the United States be better off dismantling its import restrictions (such as those on sugar, dairy products, beef, fruits and vegetables) even if other countries do not reciprocate by opening up their markets?
- Should the U.S. policy impose import restrictions on products from countries that restrict our agricultural exports?
- Should the United States establish a fund to subsidize exports in retaliation against any country that subsidizes sales to take away our farm export markets?
- What should be the U.S. policy on trade embargoes?
- Would further spending by the United States to accelerate agricultural development in Third World countries raise or lower farm exports?
- Should the United States help developing countries improve yields of cotton, grain and other crops competing with American farm commodities?
- Should the United States expand agricultural product export assistance programs, such as direct credit, credit guarantees and blended credit?

- Should PL 480 and export promotion programs be expanded to increase exports?
- To encourage more American farm exports, should measures be taken to end requirements that a share of PL 480 commodities be shipped in U.S. ships?
- Should the United States hold buffer stocks of wheat and other commodities at the public's expense to enable it to respond to emergency food needs?
- Should the Federal Reserve System be empowered to intervene in exchange markets to reduce the value of the dollar?
- Should prices for American farm commodities be supported at levels above international prices?

A panel of experts considered these questions at the televideo conference.

Henry Bellmon, former U.S. Senator from Oklahoma, warned that foreign demand for American agricultural products was on a downward trend. He emphasized the declining U.S. competitive position. Mr. Bellmon listed the 1980 Soviet grain embargo as one factor contributing to the decline in exports and the concern of trading partners about the reliability of the United States as a major supplier of food products.

D. Gale Johnson, University of Chicago, noted America's reluctance to reduce import barriers on agricultural products. Establishing a consistent agricultural trade policy is one key to improving the trade position. Some of our import barriers must be reduced through another full round of trade negotiations.

Andrew Schmitz, University of California at Berkeley, argued that the United States should not dismantle its present agricultural policy system while the rest of the world subsidizes agriculture and trade. The emergence of state trading has placed the United States, with its relatively free market system, at a competitive disadvantage. Large importers of food products are able to exercise market power and extract more of the gains from trade than the United States. He also emphasized the importance of different demands in different countries. The potential probably exists for charging a higher price to developed economies, while at the same time lowering the price of agricultural products to developing countries.

Clayton Yeutter, U.S. Trade Representative, commented that the United States must stop damaging its trade position through unilateral action. His examples included 1. unilateral reductions in crop output such as PIK 1983, which did little to affect price but instead cost a share of the market and U.S. taxpayers \$30 billion; 2. establishing a grain reserve making the United States the world's storage house at a large cost to taxpayers while other countries received the benefit; and 3. maritime restrictions that effectively raise the cost of American commodities by \$40 to \$70 per ton, making export credit programs totally ineffective.

He emphasized the need for export subsidies, export credit and other retaliatory measures to help regain the market share lost since 1981.

Although the conference fell short of suggesting a coherent agricultural trade policy, it did act as a forum to focus on important issues and to suggest alternative policies to deal with them. Further, advantages and disadvantages of alternative policies were identified. The conference established a basis that politicians could use to formulate a coherent agricultural trade policy.

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This publication is based on a televideo conference, "Agricultural Trade Policy Under Scrutiny", produced by Earl H. Brown, professor, The University of Maryland, and Luther Tweeten, professor, Oklahoma State University, on March 19, 1985. Sponsorship and funding were provided by: Extension Task Force on Agricultural Trade; Extension Service, USDA; Farm Foundation; and National Center for Food and Agricultural Policy.

**Other fact sheets in this series:**

*Ag Trade Policy Institutions for Agricultural Trade*  
*A Coherent Agricultural Trade Policy*  
*Strategies to Expand Agricultural Exports*  
*The Costs of Protection*  
*Linkage Between U.S. Economic Policies and Agricultural Trade*

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# Ag Trade Policy Institutions for Agricultural Trade<sup>1</sup>

Ag Trade 2

Jimmye S. Hillman<sup>2</sup>

## Background

Institutions that intervene in international trade are not new. The Bank of England, beginning in the 18th Century, regulated short- and long-term interest rates in the United States frontier, Australia, New Zealand, Argentina, India and elsewhere, through a balancing process in the London money market. In the United States, institutions such as the First and Second National Banks and the U.S. Tariff Commission affected trade policy by creating a new environment for monetary and trade issues. After World War I, and particularly after World War II, when the Bank of England and English commodity markets lost their centralizing and directing focus, modern trade institutions accelerated in importance.

Trade institutions have proliferated and grown for three reasons. First, they aim to reduce the adverse impact of short-term instability of commodity prices. Second, they attempt to alter the terms of trade through trade restrictions or enhancements, thereby promoting the economic growth of a particular country or commodity. Third, some encourage improved economic welfare in all countries through a general reduction in trade restrictions.

## Current Institutions

A wide variety of international institutions has been created to affect trade flows and trade policies. A partial list includes:

**The General Agreement on Tariffs and Trade (GATT).** GATT's principle purpose is to reduce protectionism between developed industrial countries. Five major rounds of GATT negotiations have been held since WW II. While tariffs and customs duties have been reduced — dramatically in

some cases — other forms of protection have arisen to clog trade channels.

**World Bank or International Bank for Reconstruction and Development.** Membership in these institutions is open to all United Nations (UN) member countries. The World Bank, through conservative lending policies and good management, has been one of the most successful UN agencies.

**International Monetary Fund (IMF).** Members of IMF include almost all UN countries. IMF can have a powerful influence on trade through its influence on lending rates and other policies of the central banks of member countries.

**Common Markets.** These include the European Community (EC), Eastern block countries (COMECON or CMEA), and the Latin American Free Trade Association (LAFTA). These groups attempt to harmonize price and other selected policies over a geographical area where common interests exist.

**Organization of Economic Cooperation and Development (OECD).** OECD is composed of the old Marshall Plan countries plus the United States, Japan and Canada. It is a forum for developed countries.

**The United Nations Conference on Trade and Development (UNCTAD).** UNCTAD, whose member countries are primarily the developing world, has attempted to promote economic development through trade restrictions to favor those countries' own domestic industrial sectors. Often these restrictions are at the expense of their agricultural sectors, and general economic development is thwarted rather than stimulated.

**Food and Agricultural Organization (FAO).** FAO consists of most UN countries. Its primary goals are to promote technical assistance and assist the developing world in producing more food.

**International Wheat Agreement (IWA).** IWA consists of surplus producers of food grains and consumer countries that are deficit in production. The IWA attempts to broadly regulate surplus and prevent wide swings in world prices.

<sup>1</sup>Compiled and adapted by Harry Ayer, Professor, Agricultural Economics Department, University of Arizona, Tucson, Arizona.

<sup>2</sup>Jimmye Hillman is Professor and Head, Agricultural Economics Department, University of Arizona, Tucson, Arizona.

**Generalized System of Preferences in Trade (GSP).** This technique has been used by the British Commonwealth as well as the French in their dealings with ex-colonial countries. The Lomé Convention, which became fully operative in April 1976, epitomizes GSP. Through this convention, the European Community gives trade preferences to 49 members, most of which are ex-colonial countries in Africa, the Caribbean and the Pacific Ocean. Their trade preferences are in the form of reduced tariffs. GSP also is part of the United States Trade Act of 1974. Special tariff rates are permitted on selected products from developing nations.

**Nontariff Trade Barriers (NTB).** NTB's are protectionist policies practiced by nearly all countries and include regulatory policies, grades and standards, health and inspection laws, etc.

## Needed Institutional Change

Widespread economic welfare is enhanced with trade between countries. Clearly our own agricultural sector benefits greatly from trade. The United States now exports about a fourth of its farm production — about \$35 billion per year. For a variety of reasons, various forms of protectionism have arisen to clog trade channels. What can be done to improve trade for more efficient production and improved consumer satisfaction? A key institution is GATT, which attempts to lower trade barriers. Observers believe the GATT system could be strengthened if these take place:

1. Countries share a willingness to abide by GATT principles, rules and codes of conduct as a minimum standard of discipline in trade policy.
2. The United States comes with "clean hands" to the bargaining table, meaning a revocation of the exceptions to trade barrier reductions (such as Section 22, which applies to dairy products) on which it has insisted since the 1950's. Europeans and Japanese also must relinquish their protectionist devices, which result in domestic prices that exceed world prices for many agricultural commodities.
3. GATT participants insist on the application of unconditional Most Favored Nation (MFN) treatment in the trade policies of all countries. MFN means that tariffs, which are reduced for one country, must be reduced for all that sign the agreement.
4. Quantitative restrictions (including 'voluntary' export-restraint agreements) must be replaced by tariffs which must be reduced when they are high, over a specified period of time.
5. Countries must incorporate procedures in domestic law for determining and effectively acquainting the public with the costs and benefits of any trade measures proposed.

## Additional Information

Additional material on trade institutions may be found in:

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# A Coherent Agricultural Trade Policy

Ag Trade 3

**Shida Henneberry, Luther Tweeten,  
David Henneberry and Mechel Paggi<sup>1</sup>**

Exports have become increasingly important to American agriculture. The share of U.S. agricultural exports as a percentage of farm cash receipts increased over the past 3 decades from 8 percent in the early 1950's to 25 percent in 1984. Exports are most important to U.S. grain producers but less important to livestock producers. In 1984, 85 percent of the cash receipts for U.S. rice and 58 percent of those for wheat were from exports. Only 4 percent of cash receipts for livestock came from exports.

The United States has had a large total trade deficit since late 1975. However, it has had an agricultural trade surplus for the past 10 years. The ups and downs of trade are related closely to the prices farmers receive and to farm prosperity.

## Issues in U.S. Agricultural Trade Policy

Agricultural trade is important to farmers and consumers. Many farmers believe farm income would increase if the United States changed its trade policy and used leverage to reduce barriers to trade with other countries. Many consumers would like to see the United States reduce its barriers to imports of sugar, beef and dairy products.

Trade policy is defined as a set of principles, laws and institutions designed to achieve goals like increasing benefits to Americans from trade. Disagreement on trade policy is widespread. Some critics say the United States has no agricultural trade policy. Others say no policy is the best policy. Depressed U.S. agricultural exports, farm financial stress and large trade deficits in recent years have heightened interest in formulating a coherent agricultural trade policy. Not everyone agrees on the components of a comprehensive trade policy. Several questions regarding such a policy follow.

1. Should a cabinet-level Department of International Trade be established to consolidate the activities now performed by various government departments and the Office of U.S. Trade Representative?

A cabinet-level international trade office would organize the policy-making process for international trade and would exert leadership toward forming a coherent policy. Although the present administration has proposed such a department, Congress has shown little interest. Between 1951 and 1975 more than 14 studies have been made to consider the organization of trade and policy activities.

**Arguments for a department.** International trade policy decisions made by one government agency, such as the U.S. Department of Agriculture (USDA), sometimes conflict with decisions made in other government agencies. For example, attempts to increase U.S. beef exports to Japan may be blunted by lobbying from auto workers to place quotas on imports of Japanese cars. An Office of International Trade could make U.S. trade policy more coherent and forceful. The cabinet-level office would give trade policy greater visibility and increased importance. Also, this office would be in a position to obtain compromises from individual groups whose interests must be reconciled in a comprehensive trade policy and negotiations.

**Arguments against a department.** The United States already has several government agencies involved in international trade policy. The Department of Commerce, the President's Special Representative for Trade, and the Department of State are a few. Although some conflicting trade policies currently are implemented, there is no guarantee that a new institution would eliminate this. The United States has a large enough government, and should concentrate on making the existing institutions address trade policy more effectively.

Some people in the private sector contend that the new department might be unduly protectionist.

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<sup>1</sup>Tweeten and the Henneberrys, Department of Agricultural Economics, Oklahoma State University, Stillwater, Oklahoma; Paggi, Texas A&M University, College Station, Texas.

This concern is expressed by Clayton Yeutter, stating that "the attitudes of the Commerce Department, which have from time to time seemed protectionist in nature, would overwhelm the open trade philosophy that has traditionally been attributed to the Office of the U.S. Trade Representative".

In addition, some people believe that agricultural issues would take a back seat to industrial concerns.

2. Would American farmers and consumers be served better if all grain exports were handled by one government grain board rather than by several private exporting firms?

Presently, various private exporting firms handle U.S. grain exports. A grain board is a central government authority directing the marketing of a commodity. With all exports centralized in a single government agency, producers would give up title to their commodities at harvest. All storage and marketing functions would be managed by the government. All producers would receive the same price (pool price) adjusted for location and quality.

**Arguments for an export board.** A government agency operates as buyer or seller in a large part of world agricultural trade. A government grain board would give the United States more bargaining power to realize a larger share of the potential gains from trade. U.S. exporters may not have information on the quantity of exports and the prices charged by other firms, while government agencies or boards purchasing farm products do. A government grain board could better implement trade policy decisions than could several private exporting firms making decisions independently. For example, if the goal is to increase farm revenues by restricting the quantity of exports and raising the international price, this decision could be executed better by one unit.

**Arguments against an export board.** Establishing a grain board would require that producers accept the board's marketing decisions and averaged pooled prices. This means abandoning individual marketing strategies with no guarantee of price increases or reductions in price fluctuations. Research from a USDA analysis indicates that the formation of a U.S. export board would not benefit American producers but would increase price instability.

3. Should the United States actively seek arrangements with other countries to control prices and stabilize markets?

These arrangements might be made with other exporting countries or with importing countries. Such agreements could take the following forms.

**A grain cartel.** Much discussion in recent years has centered on whether the United States and other major grain exporting countries should form a cartel. The cartel could raise the international price by restricting the quantity of exports. A cartel may raise total revenue by restricting supply if export demand changes relatively little in response to

a change in price. In this case the percentage decline in quantity is less than the percentage jump in price and, as a result, total revenues rise.

**Commodity agreements.** An international commodity agreement is a multilateral agreement among normally competing countries to affect the terms of trade. The terms of trade affected by an international commodity agreement may include the price level, quantity sold, quantity produced or quantity held in reserve. Legally, commodity agreements are treaties among nations.

**Bilateral trade agreements.** A bilateral trade agreement is a contract between two countries that specifies the quantity of a commodity to be traded over a certain period. Bilateral trade agreements normally run for a period of 3 to 5 years, although they may be simple 1-year agreements that are renewed annually. Normally, the agreements specify the minimum quantity a country can purchase and the maximum the country can supply. Generally, no provisions exist with regard to prices. In recent years U.S. competitors have increased their efforts to execute such agreements.

**Arguments for agreements.** With present, low-level international prices, depressed U.S. exports and market instability, these agreements may benefit America. Commodity agreements have the potential of providing a floor for world grain prices. Bilateral agreements can guarantee U.S. markets. A grain cartel would increase world grain prices by restricting exports. Bilateral trade agreements would enhance America's reputation as a reliable supplier to the agreement signatories. America's proven reputation for being able to respond to food demands when world supplies are short could be used to bargain for steady purchases, when supplies are as plentiful as they now are.

**Arguments against agreements.** A grain cartel could unduly disrupt world food markets just as OPEC disrupted energy markets. Grain importers would turn to noncartel exporting countries and pursue self-sufficiency policies in an attempt to increase domestic production and reduce imports. Exporters not in the cartel would expand production and exports.

For a grain cartel to raise farm revenues in exporting countries, the demand that exporters face must be unresponsive to price. Economists do not agree on the elasticity of demand for grain exports. In addition, many contend that, after about 4 years of restricted exports and high prices under a cartel, cartel revenues will fall.

Regarding international commodity agreements, some argue that because international wheat agreements in the past have not worked, they will not work in the future (Andrew Schmitz). Although a need for price stability is used to justify these agreements, their true objective from the exporter's standpoint is to raise prices. Also, bilateral trade agreements may commit so much production to contract markets that the few remaining open markets would experience great price volatility as they struggle to balance supply and demand.



4. Will the United States be successful in negotiating reductions in trade barriers for agricultural exports only if it is willing to negotiate lowering or removing barriers to farm commodity imports into America?

Presently, the United States has quotas on imports of sugar, dairy, beef, fruits and vegetables. Import quotas restrict the quantity of imports and raise the domestic prices of the commodities subject to import quota. Consumers lose because of higher prices compared to free trade, but producers are protected from low-priced foreign imports.

**Arguments for open trade.** Trade theory indicates that consumers tend to gain from freer trade. Producers of protected commodities are damaged by freer trade in the short run. But adjustment of resources to other higher value uses benefits producers in the long run. Other countries, through negotiations, probably would lower or remove their restriction on imports of U.S. agricultural products if America lowers or removes the trade barriers on sugar, dairy, beef, fruits and vegetables. The United States can make payments to producers and workers hurt in the process to help compensate for their sacrifices and help them to adjust.

**Arguments against open trade.** Barriers to trade are widespread. Many countries subsidize exports to the United States. Our farmers cannot compete with low-wage agriculture. The world is filled with imperfect trade competition and farmers need protection. Agricultural commodities are not the only ones with restricted imports into the United States.

Food is a strategic commodity and the nation should not depend entirely on foreign supplies. Compensation to producers and workers hurt by open trade would require large governmental outlays that taxpayers probably would not tolerate.

5. Would the United States be better off dismantling its import restrictions (such as those on sugar, dairy products, beef, fruits and vegetables) even if other countries do not reciprocate by opening up their markets?

**Arguments for dismantling restrictions.** Other countries only damage themselves by making consumers pay higher prices because of restricted imports. Other countries also hurt themselves by subsidizing exports to the United States. America should take advantage of their generosity, and not repeat their mistakes by maintaining trade barriers. Barriers serve only special interest groups. Losses to industries damaged by freer trade would be more than offset by gains to consumers. If the United States shows its commitment to free trade by dismantling its own import restrictions, even if other countries do not reciprocate, this will improve the climate for trade in the long run.

**Arguments against dismantling restrictions.** The United States should not remove its import restrictions if other countries do not reciprocate. America will never be able to persuade other nations to reduce their import barriers if it has

nothing to bargain with (Clayton Yeutter). Unilateral reductions in trade barriers are unwise because they fail to recognize the bilateral nature of international negotiations.

6. Should U.S. policy impose import restrictions on products from countries that restrict their imports of our agricultural exports?

Arguments for and against retaliatory or countervailing policies run somewhat along the lines of the previous question.

**Arguments for retaliation.** Retaliation may be the only way to open markets of other countries. Getting tough with countries that export to the United States but refuse to open their markets to American products clearly is needed (Henry Bellmon). However, tariffs have advantages over voluntary quotas as restrictive devices. As we know, voluntary quotas — as are commonly used in the United States — only help the exporting country (Andrew Schmitz). Retaliatory restrictions would help the domestic industry.

**Arguments against retaliation.** Retaliatory import restrictions could create a trade war that damages all economies. Retaliation may be unsuccessful in reducing the trade barriers of others and may leave only the United States with self-imposed trade restrictions that damage Americans as much as others. Retaliation erodes the U.S.'s reputation as a reliable supplier — one of America's most precious possessions. Trade barriers are negotiated best in multilateral agreements, such as the General Agreement on Tariffs and Trade (GATT) negotiations.

7. Should the United States establish a fund to subsidize exports in retaliation against any country that subsidizes sales to take away our farm export markets?

Export subsidies could be used to export agricultural commodities when U.S. price supports are above world prices. Overt monetary subsidies of exports seldom are made because clearly they violate GATT provisions. Under these provisions the United States could be required to pay damages to the countries injured by such subsidies. European Community (EC) subsidies do not violate GATT because they were in place as part of the Common Agricultural Policy (CAP) at the time GATT was negotiated. The last major U.S. direct monetary export subsidy was the 1972 Russian grain deal where a subsidy of approximately \$.60 per bushel of wheat was provided. Obviously, political considerations are involved in the use of such subsidies.

**Arguments for export subsidies.** Henry Bellmon said, "An export subsidy as a bargaining tool is worth consideration." It would increase exports and reduce surpluses. Clayton Yeutter stated, "The executive branch of government should at least have ample Congressional authority to protect its trade interests through the use of export subsidies if and when necessary. We ought to have enough arrows in our quiver to be able to respond

appropriately to the unfair trade practices of other nations, whenever and wherever they may occur. Whether we use them or not is a separate decision." Export subsidies are essential to retain foreign markets of agricultural products when loan rates are above world prices.

**Arguments against export subsidies.** Export subsidies are not permitted by international (GATT) rules. Retaliation is not a good policy to follow because it invites countermeasures. Most often a transfer of income from exporters to importers results. Export subsidies can be very costly to American taxpayers.

**8. What should be the U.S. policy on trade embargoes?**

The effects of trade embargoes are the same as export quotas. They reduce the quantity of exports, lower the domestic price and raise the international price for the benefit of U.S. competitors. Compensation to damaged U.S. producers raises governmental expenditures.

Since 1970, export embargoes have been imposed three times:

- in 1973, on the export of soybeans to provide assurance that poultry and hog producers would have a sufficient supply of soybean meal to continue efficient production;
- in 1975, on exports of grain sales to the Soviet Union after concern spread about increasing food prices and the rumor that bread prices would rise to \$1 per loaf; and
- in January 1980, on all exports to the Soviet Union after the Soviet invasion of Afghanistan and the subsequent tensions in Poland. This embargo was lifted in April 1981.

**Arguments for embargoes.** Trade embargoes are a political tool used occasionally whether or not producers like them. An appropriate policy for producers is legislation to a) ensure that embargoes will be imposed only in a national emergency with full compensation to producers, b) require approval by Congress for continuation beyond 60 days, and c) ensure sanctity of existing contracts. These provisions would retain the option to embargo but assure that it be used sparingly.

**Arguments against embargoes.** Grain production and trade are so decentralized that no one country can impose effectively a grain embargo against any other country. Other exporters will supply the embargoed country, especially if world supplies are adequate. A unilateral embargo is counterproductive for the United States. In the case of the Soviet Union, the United States was the loser (Andrew Schmitz). Embargoes harm America's reputation as a reliable source of supply and traditional importers could turn to more reliable sources. For these reasons, export embargoes should be ruled out as a political or economic weapon.

**9. Would further spending by the United States to accelerate agricultural development in Third**

World countries raise or lower farm exports? Should the United States help developing countries improve yields of cotton, grain and other crops competing with American farm commodities?

In many developing countries, agriculture is the major economic sector and employs a large percentage of the population. Sluggish or declining economic growth in developing countries has dampened demand for American exports.

**Arguments for foreign development.** The prosperity of developing countries is the key to their increased imports of our farm products. Because most of their income originates in agriculture, their economic progress depends heavily on agricultural progress. It is in our self-interest to improve the productivity of their agriculture. U.S. exports can be expanded as a result of their accelerated economic growth. As incomes grow so does the demand for red meat and other livestock products. The demand for grains expands to feed livestock. U.S. exports of soybeans and feed grains to these countries will increase, although U.S. exports of rice, wheat or cotton may decrease. South Korea, Taiwan and Japan are countries where U.S. farm exports were helped by economic development and progress in agriculture.

**An argument against foreign development.** As the United States transfers its technology for increased production to developing nations, these countries will become more self-sufficient in agricultural products and reduce their demand for agricultural imports from the United States.

**10. Should U.S. agricultural export assistance (direct credit, credit guarantees and blended credit programs) be expanded?**

Presently, with sluggish foreign demand, most exporting countries have export assistance programs for promoting exports.

**Arguments for export assistance.** The currently overvalued dollar essentially is a tax on U.S. exports that calls for a compensating export subsidy. The high dollar has reduced the United States' share of world exports. Expanded export assistance programs could maintain or increase the United States' share of world trade. Export assistance also can be effective when provided to countries where the foreign debt burden severely limits imports from the United States. The United States has three major programs: 1) Blended credit is a form of export subsidy that combines direct government export credit and government credit guarantees with commercial credit in a single package to reduce the effective interest rate; 2) GSM-5 provides direct government export credit; and 3) GSM-102 provides government credit guarantees.

**Arguments against export assistance.** Export assistance programs are very costly to the government and American taxpayers. These programs may invite retaliation by competing exporters. Such assistance does not necessarily expand U.S. exports.

11. Should PL 480 or the export promotion programs or both be expanded to increase exports?

Promotion programs and PL 480 do expand exports; however, they are costly to the government. Presently, about 10 percent of feed grain exports are exported under PL 480 programs.

PL 480 allows concessional sales of commodities involving price or credit terms that contain substantial U.S. subsidies. Exports are made under three PL 480 programs.

1. Title I involves sales for dollars with low interest rates and up to 40 years to repay.
2. Title II involves emergency food relief directed to nutritionally vulnerable groups.
3. Title III involves commodity aid as part of a developmental package. Multiyear commitments are tied to specific developmental actions.

PL 480 is credited with having built such important commercial markets for farm products as Japan, South Korea, Taiwan, Brazil and Spain.

**Arguments for expanding PL 480.** It is cheaper for the government to export surpluses than to pay farmers not to produce them. PL 480 is an export promotion program that creates new long-term commercial demand for our farm products. For humanitarian reasons alone, the United States ought to expand PL 480 loan and grant programs to nations with compelling hunger problems.

**Arguments against expanding PL 480.** In recipient countries, PL 480 imports lower farm prices, crowds out domestic production and creates disincentives for local farmers. PL 480 crowds out commercial exports and is less effective than a transfer of technology in meeting food needs of developing countries. The worth of PL 480 is severely eroded by lack of port facilities in the recipient countries, corruption in the distribution process and by the adverse impact of donated agricultural surpluses on incentives in developing countries. PL 480 is very costly to the United States.

12. To encourage more U.S. farm exports, should measures be taken to end all requirements that a share of PL 480 exports be shipped in U.S. vessels?

The American government, in an effort to support the merchant marine industry, has mandated that half of the bulk commodity shipments under governmental programs (such as PL 480) be transported on U.S. flag vessels.

**Arguments for ending U.S. cargo preference.** Because the cost of shipping on U.S. flag vessels is significantly higher than on other vessels, U.S. agricultural exports have suffered. The added expense of the cargo preference requirement more than offsets credit assistance (GSM-5, GSM-102 and blends thereof), rendering such assistance inoperative.

**An argument against ending U.S. cargo preference.** U.S. cargo preference legislation supports maritime workers and the merchant marine

industry. Without this legislation, foreign flag vessels would replace the U.S. maritime industry. The maritime industry, like agriculture, must be preserved for national security.

13. Should the United States hold buffer stocks of wheat and other commodities at public expense to enable it to respond to emergency food needs?

The U.S. holds most of the world's carryover stocks. From 1979 to 1983, the U.S. accounted for nearly 44 percent of the world's carryover stocks of wheat and over 80 percent of coarse grains.

**Arguments for U.S. reserves.** Reserves of grain help the United States capture a larger share of world markets if world supplies are short and prices high. As a wealthy nation with an abundance of agricultural products, the United States plays an important role in stabilizing world markets and meeting emergency food needs. The private storage trade would not provide sufficient reserves. The United States has most of the reserve grain to meet emergency needs of the world and this grain provides substantial stability to the world market. Importing countries would probably adjust their domestic grain policies if they were to face more risk of shortages. These adjustments could include pursuing self-sufficiency policies, negotiating bilateral contracts with other exporters and building their own stocks. All of these adjustments would eventually lead to fewer U.S. exports.

**Arguments against U.S. reserves.** The United States holding of buffer stocks for the emergency needs of the rest of the world is very costly to taxpayers. Excessive buffer stocks unduly depress farm prices. The United States does not need to hold a large buffer stock for economic reasons. By cutting exports this country could meet domestic food needs even if the weather was unfavorable and production low. The private trade might hold sufficient stocks if the competition from governmental storage programs was removed.

14. Should the Federal Reserve System be empowered to intervene directly in exchange markets to reduce the value of the dollar?

Since 1973, the dollar has fluctuated greatly against most currencies. The dollar depreciated from 1971 to 1979, but has appreciated since 1980. The recent appreciation of the dollar has hurt U.S. exports by making U.S. commodities more expensive in foreign currencies. The Federal Reserve is not now empowered by Congress to affect exchange rates directly. However, the government has the authority to intervene in foreign exchange markets when the markets become particularly volatile, and has announced its intention to do so from time to time.

**Arguments for intervention.** Depreciation of the dollar would raise U.S. agricultural exports. Intervention by the Federal Reserve could be more forceful than past interventions. The interventions would reduce the value of the dollar by discouraging speculation.

**Arguments against intervention.** Some argue that the exchange rate is not the main cause of decreased U.S. exports. A policy aimed at the source of the problem, large structural Federal budget deficits, would reduce real interest rates and the exchange rate. Higher interest rates have caused appreciation of the dollar by attracting foreign funds to the United States. Exchange rate intervention treats symptoms, not causes.

**15. Should prices for U.S. farm commodities be supported at levels above international prices?**

Loan rates act as a price floor for U.S. agricultural commodities. In most years since 1950, the nonrecourse loan program has supported American farm grain prices and world grain prices. In recent years U.S. loan rates have exceeded world commodity prices and the result has been loss of exports and a price umbrella that supported competing exporters.

**Arguments for high supports.** Because of high real interest and dollar exchange rates, farm costs of production will exceed market prices. Loan rates above world prices are unavoidable if producers are to receive even minimally adequate prices.

**Arguments against high supports.** High loan rates price American farm products out of world markets. Over time the economy is damaged because farm export earnings fall or are maintained only with export subsidies. Also, foreign countries will expand their production and decrease our potential export markets.

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# Strategies to Expand Agricultural Exports

AgTrade 4

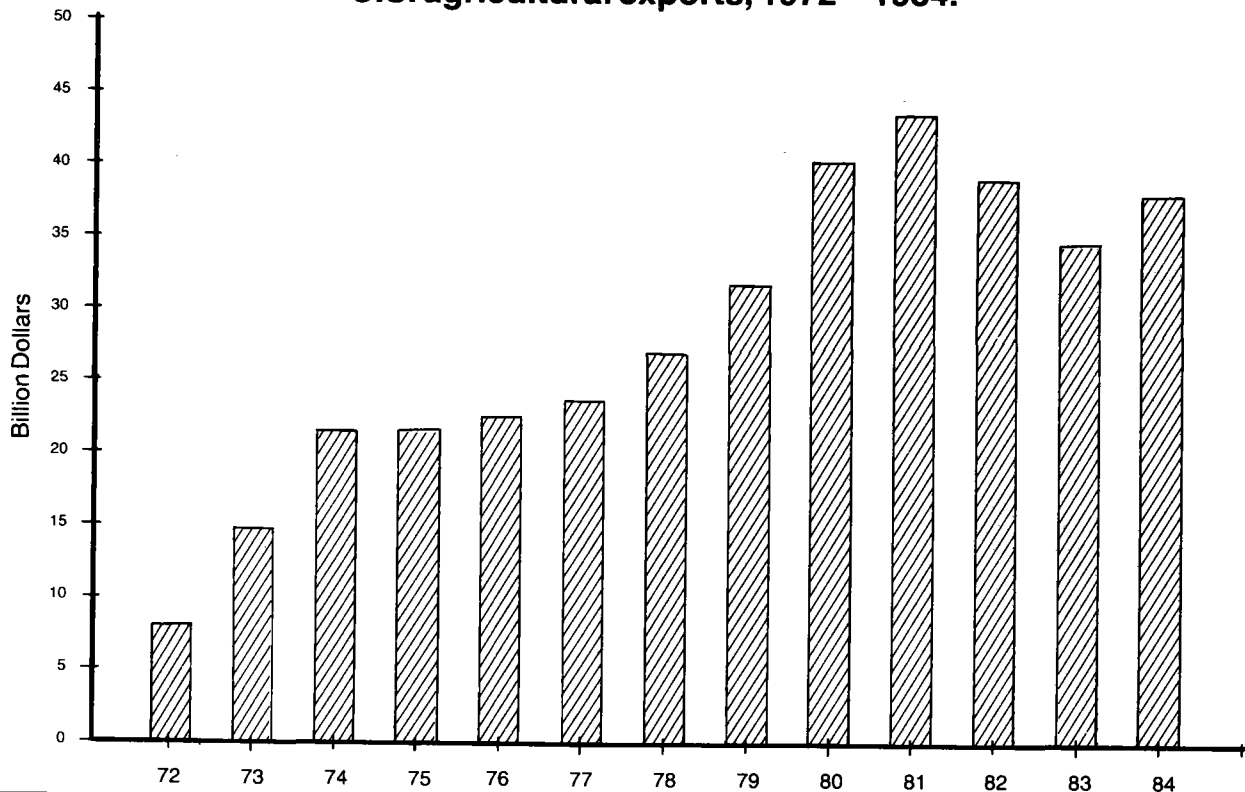
Earl H. Brown and Jeffrey Charlesworth<sup>1</sup>

In the 1970's, the American farmer plunged into world agricultural markets. Worldwide demand for food outpaced supply, and countries looked to the United States for help. At the same time, the United States saw a need for new sources of export revenue to meet the skyrocketing cost of oil imports.

In the decade since that plunge, the value of U.S. agricultural exports has increased a phenomenal fivefold, from about \$8 billion in 1972 to \$38

billion in 1984. This increase in the value of exports has come primarily from two sources. First, inflation and greater demand pushed up prices so that farmers earned more from what they were already exporting. About two-thirds of the higher earnings resulted from those higher prices. Second, the volume of exports rose. The other third of the higher earnings came from more than doubling the tonnage between 1972 and 1984—from 67 to 144 million metric tons.

**Value of  
U.S. agricultural exports, 1972—1984.**



<sup>1</sup>Professor and Extension Assistant, respectively, Department of Agricultural and Resource Economics, The University of Maryland.

## Volume of U.S. agricultural exports, 1972—1984.



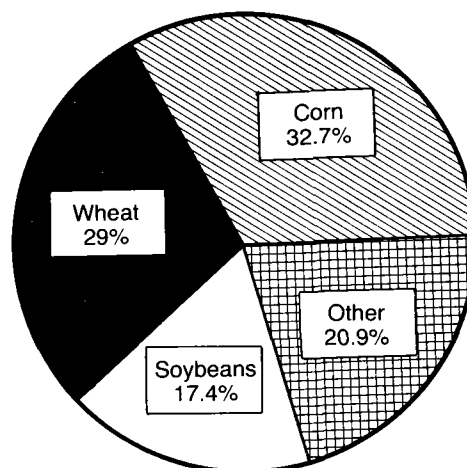
The importance of export sales to U.S. farming has grown. In 1980, agricultural exports accounted for almost one-third of all U.S. farm receipts. By 1983, the share had fallen to about one-fourth of farm receipts, but was still nearly double the level of the early 1970's.

The United States exports a wide variety of agricultural products. However, the big three—corn, wheat and soybeans—account for about three-fourths of all export tonnage. Much of the world demand for agricultural exports is for grains, and the United States meets a substantial part of that demand. In 1984, world agricultural exports of grain added up to a staggering 232 million metric tons and represented about 15 percent of grain consumption worldwide. The United States, which grows about 20 percent of the world's grain supply, also is the largest exporter. During the 1970's, the United States' share of world grain trade ran as high as 53 percent. In recent years, the United States has provided about 40 percent of the world export market for wheat, 50 percent of the world corn market and 60 percent of the soybeans exported around the world. The United States also has an important part of world markets for cotton, rice, tobacco, logs and forestry products.

Although exports account for about 25 percent of U.S. farm sales, the figures for the big three export crops run higher. American farmers can produce far more of these products than the nation can consume. In recent years, the United States has exported about half of its wheat and soybean crop and a fourth of its corn crop.

The importance of international markets to U.S. farming became apparent during the last 15 years. Agricultural exports help keep farm prices high. In the 1970's, farm prices rose with exports. When

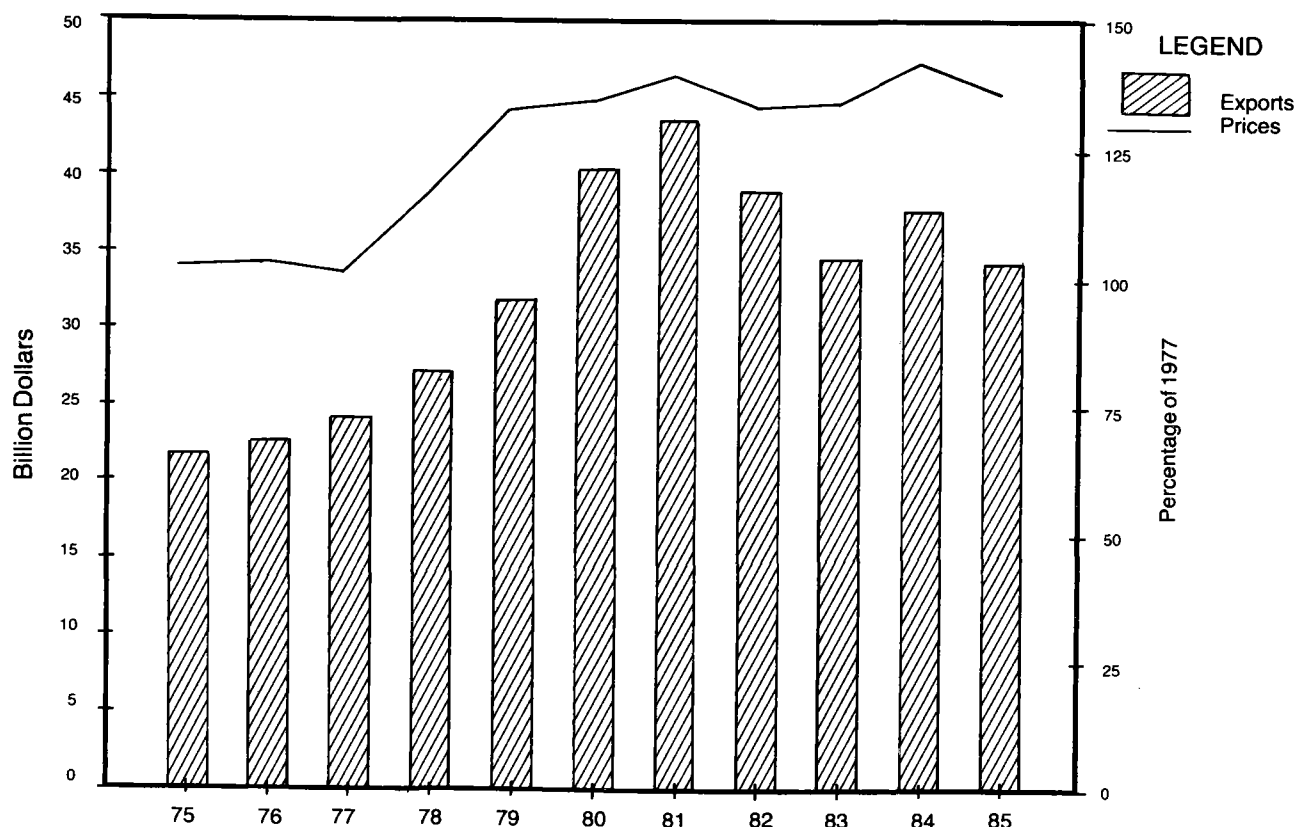
**Commodity shares of U.S. agricultural exports by volume, fiscal year 1984.**



Source: USDA, ERS/FAS, "Outlook for U.S. Agricultural Exports," December 3, 1984.

exports fell, so did farm prices. It was in the early 1970's that two important policy changes paved the way for the tremendous growth of farm exports. First, agricultural policy no longer supported prices above world levels. A market-oriented policy let world supply and demand determine prices which, in turn, opened world markets to American agricultural products. Second, the United States devalued the dollar in 1971 and again in 1973, which, in effect, reduced the price of American farm products abroad. As expected, other countries started buying more. Other factors that played a role were: expanding economies around the world, easy credit and decisions by the Soviet Union and China to increase imports.

## U.S. agricultural exports and farm prices fiscal years 1975—1985.



In the early 1980's, some of these factors were reversed and the farm export bubble burst. Agricultural exports began to fall for the first time in almost 10 years. Farm prices and incomes dropped to depression lows, and surpluses increased dramatically. Several factors worked against the American farmer: a worldwide recession cut demand, a strengthening dollar made purchases more expensive to other countries, greater production in other countries took away part of our markets and the grain embargo forced importers to look elsewhere.

Fiscal, monetary and trade policies on nonfarm goods also can affect agricultural trade. For example, the large Federal deficit partially is responsible for economic growth, investment opportunities and higher interest rates in the United States. This situation has attracted foreign investors, who bid up the price of the dollar. As the value of the dollar increased, farm prices of exports priced in dollars also increased. Because of this, Agriculture Secretary John Block said that the best farm bill for 1985 could well be a balanced budget.

Agricultural trade is a large, complex and very competitive business with high stakes, excellent rewards, but potentially devastating results. Much of the complexity of international trade stems from the different governments, languages, currencies, policies, regulations and customs involved. Prices and exchange rates can change substantially between the time of purchase and the time of delivery. Governments can change policies and regulations on short notice. Practices that are common

in some countries are illegal in others. Given such an environment, it is not surprising that world trade in agriculture is dominated by a relatively few, large, sophisticated buyers and sellers who have mastered these complexities understood by few outsiders.

The United States exports large amounts of wheat, corn, soybeans, tobacco, cotton and rice to countries that cannot produce enough to meet their needs. The United States, in turn, imports what it cannot grow, such as coffee, tea, cocoa and bananas. Trade seems to benefit everyone involved. But if it does, why do countries adopt policies to prohibit or restrict trade?

Countries erect trade barriers mainly to protect domestic industries from foreign competition, especially if such competition is thought to be unfair. Tariffs, quotas and levies can be used to restrict trade. Licensing, inspections and bureaucratic procedures also can make selling products difficult in some countries. Countries may use export subsidies to take markets away from competitors.

Trade restrictions are not new, nor are efforts to reduce them. In 1946, an event of paramount importance took place in Geneva, Switzerland. Leaders of 22 countries met to discuss ways to reduce trade barriers and expand international trade. The outcome was the General Agreement on Tariffs and Trade (GATT), which still guides international trade. The purpose of GATT is to reduce trade barriers, expand trade and establish a set of principles and guidelines for international

trade. An additional and important role is to settle disputes and infractions of member countries. Today, a GATT committee on agricultural trade is revising these rules in an attempt to reduce trade barriers and subsidies.

International trading patterns and practices change often and sometimes unexpectedly. One change of great importance to the United States has occurred in its relationship with the European Economic Community (EEC). Following World War II, the United States became a major supplier of farm products to EEC. Since then, EEC, as a result of its Common Agricultural Policy, has become a major exporter of several farm commodities that directly compete with American agricultural exports.

Both sides believe they have a right to a fair share of the world market and criticize each other for using unfair methods of competition. Sir Roy Denman of EEC said "the EEC cannot and will not accept that its farmers do not have a right to make a living selling overseas, providing they abide by the international trading rules. The Community is not prepared to be a scapegoat for the difficulties of U.S. agriculture."

A statement made by Senator Jesse Helms, chairperson of the Senate Agriculture Committee, illustrated the American position when he said, "We do not seek a permanent policy of export subsidies. Certainly, we do not seek a trade war. But, we do seek an opportunity for U.S. farmers to compete on a fair basis with their counterparts overseas, and we intend to stand up for American interests."

Trade disputes are not restricted to EEC. Difficulties in agricultural trade also have occurred with the Soviet Union, China, Japan and others.

Agricultural trade negotiations often bring domestic farm programs and policies into question. So far, no country has been willing or able to engage in serious negotiations with other countries for changes in trade policies that affect domestic agricultural programs and policies. Domestic farm policies often conflict with agricultural trade policies since the success of domestic farm price and income programs may require control over international trade.

When governments intervene in agricultural markets through price supports or commodity loans, import restrictions may be needed to keep down costs to the public treasury. In addition, if domestic output is larger than the amount that can be sold in the market at the artificially higher price, export subsidies are needed to prevent the accumulation of stocks.

All Americans must be concerned about the drift toward protectionism that is gaining momentum here and abroad. A world recovering from an economic recession and wishing to avoid another offers a propitious moment to address pressing agricultural trade and development issues. The internationalization of American agriculture means that farm markets cannot be viewed in isolation, but must be considered an integral part of the world capital and commodity markets. American farm income is tied closely to the strength of export markets and the impact of economic and polit-

ical events abroad are felt keenly by American farmers and consumers.

An attempt to address these issues was made at a national conference, "Agricultural Trade Policy Under Scrutiny," that brought together academicians, farm leaders, commodity organizations and policy makers to discuss actions that could be taken to expand agricultural exports. Dr. Earl Brown, professor of agricultural trade at The University of Maryland, moderated a panel consisting of Leo Mayer, Associate Administrator, Foreign Agricultural Service, U.S. Department of Agriculture; Bruno Julien, Agricultural Representative, Commission of the European Community; and Ken Bader, Chief Executive Officer of the American Soybean Association. Excerpts from their discussion follow.

**EB:** The United States has 60 percent of the world soybean market. Isn't this really pretty good? How much do soybean growers want—all of it?

**KB:** Yes. Quite frankly, anyone competing in private enterprise wants as much of the market as possible. I'm concerned about our market share for soybeans. It has dropped from 70 to 75 percent a few years ago to the present level of 60 percent. Equally, we have to be concerned about the size of that market and how to increase it.

**EB:** Has the decrease in exports over the last 2 years affected commodities equally?

**LM:** No, grains have certainly suffered more than other products. Wheat exports are down about 10 million tons. Rice is also down substantially. Feed grains have dropped off, but have come back somewhat. Livestock products have done relatively well.

**EB:** Having just returned from Africa and the Middle East, what is the potential for agricultural exports to these countries?

**KB:** Algeria and Turkey were two of the countries I visited. I was impressed by efforts in market development and the opening up of both these markets to American agricultural products. Just as one example, Turkey imported 77,000 tons of soybeans last year. I think, however, the major problem for U.S. commodities is the high value of the dollar. The U.S. prices for agricultural commodities, hydraulic equipment and other products were as much as 25 to 30 percent over our competitors. We are simply priced out of the market.

**EB:** How much of the decline in agricultural exports since 1981 is due to the strong dollar?

**LM:** In my judgment, the dollar effect has been overstated. Basically, most people who look at the rising value of the dollar do not look at what's going on in the country affected. If we deflate for the rate of inflation, we get a more realistic assessment of the value of the dollar. In Mexico, for example, the cost of everything has gone up considerably more than the cost of the dollar. In my view, the strong dollar has had its most serious impact on a few commodities in a few countries. For example, soybeans going into Europe.

**KB:** I agree. The dollar has been particularly devastating to soybean exports to the European Community, which imports around 40 percent of



our total exports of soybeans and soybean products. In deutschmarks, soybeans run \$10 to \$11 per bushel. The decreasing price that we've seen here in the United States has been more than offset by exchange rates, particularly in European currencies. The export drop is also due to the inability of less developed countries to buy at any price.

**EB:** How much do you feel the value of the dollar has affected imports from the United States into EC?

**BJ:** I think that the value of the U.S. dollar against EC currencies is quite important. But, it's difficult to assess the exact impact. To come back to soybeans, I don't think the effect of the dollar is the only problem. We decreased our imports of U.S. soybeans for other reasons. First of all, we shifted to other countries for some soybeans. We also had very large cereal crops in 1984 and 1985, which were used in part for animal feed. And, of course, until recently we had high, internal prices so the rising value of the dollar had little effect. We also implemented a quota on dairy production, which had an impact on imports of U.S. soybeans. Also, the dollar is helping us. We increased our exports of wine, for example. As a result, protectionist pressures are beginning to build in the United States for measures like the Wine Equity Bill.

**KB:** This is a classic example of domestic policies having a dramatic effect on import and export policies.

**EB:** The American farmer believes he is the lowest cost producer in the world. He likes to say that if other countries would remove their trade barriers, he could do all right. But if he has to compete with the governments of other countries, he's in trouble. Do you think American farmers can compete with other farmers in the world?

**LM:** You cannot look at just the cost of production of American farmers. We have a total agricultural production and marketing system, which is second to none anywhere in the world. The difficulty is that we've gotten this system out of equilibrium through some farm policies over the past 4 years. We are now trying to change to a more flexible, more market-oriented set of policies. We think that this is as important as any step we can take. It isn't a lack of productive capacity. It isn't a lack of a system to export. It's the lack of governmental policies that can facilitate those exports.

**EB:** How important are agricultural exports to European farmers?

**BJ:** We need exports to balance our imports. So if we want to import more, we have to export.

**EB:** Many U.S. farmers believe that the European Common Agricultural Policy, commonly called CAP, really is an unfair method of competition. Is that so?

**BJ:** No. What you call unfair is mostly our system of export subsidies and import levies. I don't feel they are unfair because they were agreed to during the last round of GATT negotiations. On your side, you obtained the GATT waiver, which you use to limit the imports of products such as

sugar and beef. I would say that's an unfair trade practice. So let's say we have balanced our concessions during the last round of discussions. I think you recognize that you have no problems with us over soybeans because we don't even have a levy on them. I also want to mention the EC proposal for a vegetable oil tax. It's true we had an interest in taxing all vegetable oil, not just soybean oil. But something similar in the United States has gone unnoticed in the last few months. Your House and Senate raised the tax on alcohol. We have been hurt, but we haven't complained.

**KB:** I'd like to add to the point about lowest cost producer. I think nothing has devastated U.S. farmers more in the last few months than to realize that multinational grain firms could buy Argentine or Brazilian wheat and bring it into the United States more cheaply than the firms could buy it here. That brought to the fore, more than anything I know, the fact that policies in those countries offset the low cost of production in the United States. Many people think that farmers in Argentina and Brazil are highway bandits for the price they're getting. Today the price for soybeans in Brazil is somewhere around \$3.70 to \$4.00 a bushel compared to \$5.75 to \$6.00 in the United States. U.S. wheat costs about \$43 per ton more than wheat from Argentina. I think what is really reflected is the difference in governmental policy and the need those countries have to export to help their external debt situation. In Argentina, they can change the value of the peso to make their exports competitive—and they do. The United States will continue to be, with our great infrastructure and great agricultural plant, the least cost producer for many agricultural products. But, at the present time, given the great differential that exists in the macroeconomics of the world economies, we're going to have aberrations.

**EB:** Do you think that reducing trade barriers is the most important thing that could be done to increase agricultural exports?

**LM:** No. Getting our farm policies and programs in order is the most critical issue. Trade barriers are only a piece, although an important piece, of a very complex issue. We're working very hard to reduce and remove them. We would opt for free trade, but this is not possible in the short run. We hope to move in that direction.

**KB:** I would lend a little more importance to trade barriers. Market development is a total package—it's having a presence, promoting the crop through funds that farmers provide through checkoffs or through the assistance of the Foreign Agricultural Service. It's a package our government should consider as paramount if we need to export, and we do. I think we have a long way to go to get that mentality straight, and to get interagency cooperation to ensure that we put the total package together in a way that we can be competitive.

**LM:** I don't want anyone to think we don't see trade restrictions as important. We see them as very important, but they probably aren't most important. We need to organize ourselves and compete with other producers around the world. It comes back to the 1985 farm program.

**KB:** I disagree in that I think the situation varies by commodity. Soybeans have had the market-oriented policy that the administration desires, but still there are problems. We need to look seriously at trade and macroeconomic policies.

**EB:** What are the major features in the proposed 1985 farm bill?

**LM:** One feature that would really have an effect on exports is the proposal to lower loan rates to 75 percent of the average of the past 3 years. This would allow us to be more competitive. Making our prices more competitive doesn't necessarily mean lowering incomes to farmers because we have other ways of protecting farm income. The second feature is strengthening our trade policy to increase exports.

**KB:** We need to make sure that we include a strong export commitment in the 1985 agricultural bill, and I say agricultural because it's more than just farm. I'm advocating that Title I of the agriculture bill be export-oriented with a very strong commitment on the part of the United States to deal appropriately with unfair trade practices to help level the playing field. If we have that strong commitment on the part of our government, I think we can gradually return to a system where we are all playing on the same field. This will, of course, go against some financial interests because some of these countries owe considerable money to our banks.

**EB:** How does it help farmers if we sell more but at lower prices?

**LM:** Volume is as much a factor in total returns to farmers as is price. We've heard much about prices for 50 years, but not much about quantity. If you lower prices and increase exports by a larger percentage, your total revenue will increase.

**EB:** Do you agree with that, or would we end up selling more for less and be worse off?

**KB:** There are two parts to the equation. Export volume is important, but look at total revenue from a farmer's point of view. He can increase revenue in two ways: increase the yield or reduce the input and production costs. So, in my opinion, agricultural research and increased productivity are very much related to export competitiveness.

**LM:** Wouldn't it also be true that the closer to capacity a producer can operate, the lower his cost per unit will be? So, to the extent we can get volume moving, he can lower his unit costs and make more money.

**KB:** There's a huge opportunity cost being incurred by all of U.S. agriculture by having our plant producing at less than full capacity. Let me suggest here that our friend Bruno lies awake at night worrying about the declining dollar and a flexible loan rate because the expenses of CAP would increase. Bruno, I'd like you to comment about that.

**BJ:** Sure, we don't favor a decrease in the loan rate for several reasons. We think our farm prices are already depressed and we don't want to depress them further. We think that our farmers and your farmers are facing very difficult economic conditions. In the past several years we've decreased the number of our farms substantially from about 20 million farmers to about 6 million

in order to improve our productivity and our structure. It's not prudent to decrease the prices to such an extent that they would cause a new departure from farm areas. We want to keep at least a minimum number of farmers on farms. Also, if we lower prices, who would benefit? The commercial buyers, like the USSR, for example, would benefit. Will they buy more if you lower the loan rate by 20 to 25 percent? I'm not sure about that. We should try to expand the total market. Can this be done by lowering the world price? I'm not sure.

**LM:** Does expanding the market mean feeding hungry people around the world? As you know, the United States increased food aid this year by several hundred million dollars. What is the Community's position on increasing food aid?

**BJ:** We increased our food aid tremendously, particularly in those countries affected by the drought. But, I want to come back to the farm bill because we have our own kind of farm bill in Europe. We are also changing our policies in order to adapt to the current market situation. We haven't made much noise, but our farmers are complaining a lot. In the past 2 years we implemented a means of production control. The quotas on dairy production are now in place. We also implemented some guarantee thresholds on cereals and oilseeds which will penalize producers if they overproduce. They no longer have an open-ended guarantee. We have been limiting our share of the world wheat market to 14 percent for the past two seasons. Will we go beyond these? Certainly. Our ministers are working on that now. We lowered farm prices for the fiscal years 1984-1985 and 1985-1986. The price of wheat will be 3.6 percent lower. So we think we are going in the right direction. We cannot change our policy in 1 year or in 2. It's a long-term process.

**EB:** We've talked about other countries being able to undercut U.S. prices. Why does this happen?

**KB:** Basically, it's because we have a different pricing system. Ours is based more on a free-marketing system, whereas in many other countries, the price is set by government action.

**LB:** I don't want anyone to think we're insensitive about not being price competitive, but we've been locked into prices since the 1981 farm bill was put into effect. It simply prices us out of the market for at least wheat and rice, and until we can change that, we're not going to be competitive. That's why the 1985 farm bill is so important to us. It gives us an opportunity to unlock ourselves from an inflexibility that has existed for 4 years. We tried various methods in the last 4 years to be competitive. We tried providing more credit, but that has not been adequate. We tried more market development. We tried harassing EC and Japan to lower their trade barriers. But nothing is a substitute for being price competitive.

**EB:** Could a barter system be used to export more grain?

**KB:** Yes, but it's much more difficult than many people realize because you have changing prices of two commodities, and it's difficult to put both ends of the deal together. Some amount of barter is occurring in the world, and there are examples

where U.S. firms are involved in barter trade of agricultural commodities.

**EB:** Does being more competitive mean that some American farmers will go out of business?

**LM:** Well, that's a difficult question. There are some farmers who are facing very difficult times because of when they began to farm, how much they've expanded in the past 2 to 5 years, and the interest rates they're paying. For those farmers, it may be very difficult to be competitive enough to meet the prices existing in global markets. We have to recognize that there is an overcapacity to produce food in the world today. The technology explosion has expanded the capacity to produce food, grain and other commodities at a very rapid rate.

**EB:** Do you mean overcapacity in terms of what people can afford to buy?

**LM:** Yes. I was encouraging Bruno for that very reason to think about more food aid. We'd like to see all that additional wheat production in EC go into food aid as opposed to commercial markets. The best way to resolve this question of who's going to produce these commodities is through competitive pricing. It's the only system that really works. I would point out that starting in 1982 we implemented a supply control program. We asked Canada, Australia, Argentina and the Community to share this burden of overcapacity. Unfortunately, as we cut back they all expanded production, which led us to believe that negotiation alone is an inadequate means to get an agreement on who should cut back. It's going to take a much stronger effort, and the pricing system is the only thing we see that is strong enough to do this.

**BJ:** I don't agree completely with what you say. Remember, in 1983, we had some talks about the wheat market and you asked us to reduce our production. What we told you was we could reduce our market share and not disturb the world market and that's what we did. Of course, we produced more and our stocks went up from 6 million tons to 12 million tons. This year for the coming campaign our stocks will grow to 15 million tons. Also, we have been implementing a guarantee threshold, which is an effort to persuade our farmers to reduce production. This is not going as far as you want, but it's a movement in that direction.

**LM:** As you know, stockpiling more and more wheat will work for 2 or 3 years, but eventually production must be reduced. We took the step of bearing the enormous cost of cutting back production in this country and we looked around the world to see who would join us in sharing that burden and no one stepped forward. These stocks overhang the market and must find a home either through more feeding of wheat or some other mechanism.

**EB:** We've been talking about lowering prices and moving towards a free-market economy, but some farmers and farm organizations are advocating that we increase prices instead, saying that we can't cover costs now. What would happen to U.S. agriculture and agricultural exports if we followed that policy?

**LM:** If we increase prices, we have two options. First, we can produce for the domestic market and

an ever-shrinking export market. And second, we could implement export subsidies. But, this would have several ramifications. We would be selling food to other countries at lower prices than we charge U.S. consumers. We're not interested in competing with other countries in just agriculture. We also compete in the industrial area. If we supply Japan with food at a substantially lower price than we supply our own people, they could use that saving to subsidize their industrial products and out-compete us in the industrial sector. Export subsidies, in the long run, will be self-defeating.

**BJ:** I think you are already export-oriented and you are looking for an even more export-oriented policy. Your U.S. Department of Agriculture budget includes money to increase exports, Commodity Credit Corporation (CCC) guarantees, PL 480 and blended credit. I think you already have tools and you are using them. I would like to add something about lower world prices. Don't you think your deficiency payments are already artificially lowering the world prices? Target prices generally are not sufficient to sustain farmers. Now you're thinking of cutting the deficiency payments and lowering the loan rates. What would happen to the farmers? Would 20 or 30 percent disappear?

**KB:** I would separate income transfer through deficiency payments from export subsidies which, in my opinion, have more effect on the world prices.

**BJ:** You separate the two, but the United States and EEC have two completely different policies. Ours is based on high internal prices. Yours is based on deficiency payments. I won't say which one is better. We have different policies and both of these policies interact on the world market.

**LM:** Deficiency payments do provide some income to farmers, but it's relatively minor. In most years they cost far less than the export subsidies of the Community. We have a policy of providing food to our domestic consumers at the same prices as to our overseas customers. This brings me back to the fact that I cannot see how providing food more cheaply to your export customers than you do to your domestic customers can be anything but self-defeating. You have to compete in the industrial sector with those countries. It seems to me that the economic stagnation of Europe is at least partly caused by its relatively high food and labor prices.

**EB:** The administration has proposed moving toward a free-market system in the 1985 farm bill. Does this mean the United States is ready to remove trade restrictions on sugar, dairy products, meat, fruits and vegetables?

**LM:** Yes. In recent GATT discussions we have offered to put all of our trade restrictions on the table, if other countries would do the same.

**EB:** Wouldn't that actually increase our imports and thus increase our overall trade deficit?

**LM:** Not if we get free trade in other countries because exports will expand at an equal or greater rate than imports.

**EB:** As a means of summarizing, would you outline the major efforts presently being used by the United States to increase agricultural exports?

**LM:** Our major strategies are to modify domestic agricultural policy so our prices will be competitive and to reduce the Federal deficit to reduce exchange rates. Other strategies include multilateral and bilateral negotiations to reduce trade barriers, PL 480, blended credit and targeted use of surplus stocks as incentives to exporters.

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# The Costs of Protection

David Blandford<sup>1</sup>

The terms "protection" and "protectionism" often are used to describe the application of measures such as tariffs or quotas by governments to restrict the flow of imports and, therefore, to protect domestic industries from import competition. However, protection is much wider in scope than this narrow definition would imply. Any policy that insulates domestic markets from international competition can be considered protectionist in nature. A government that supports the prices paid to domestic producers or subsidizes consumer prices is using protective policies. Similarly, a government that provides subsidies to promote exports is just as protectionist as the one that imposes a tariff on imports.

The term protection covers a wide range of policies that can be either domestic or external in orientation. Furthermore, protectionist measures may be used by both importing and exporting countries to change the balance of competition. This is particularly true in agriculture where governmental involvement in supporting producers' incomes and controlling domestic markets is extremely widespread.

## The Scope of Protection

Protection often is achieved through measures such as taxes or quantity restrictions that influence trade directly. Since importing countries use many of these measures, they have been classified into tariff and nontariff barriers to trade. Protection also can be achieved through the use of various domestic taxes and subsidies. These influence domestic production or consumption and have an indirect effect on trade. The principal categories of protective measures can be divided into:

- levies or subsidies on trade such as import tariffs and export subsidies;
- quantity restrictions such as import quotas, export embargoes;
- procedures or standards such as health or labeling requirements;

<sup>1</sup>Associate professor, Department of Agricultural Economics, Cornell University, Ithaca, New York.

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- government trading such as export marketing boards, state purchasing agencies; and
- domestic taxes or subsidies such as input or transportation subsidies, consumer taxes or subsidies.

In the past, the use of import **tariffs** to increase the cost of imports was widespread. Tariffs were easy to apply and generated revenue for the government. Although tariff rates have been progressively reduced on most industrial products since the end of World War II, they are still important in some countries for agricultural products. As seen in Table 1, Japan still has an average tariff of over 20 percent on food imports. Many developing countries have similarly high rates.

**Table 1. Average tariff rates on food and agricultural raw materials — the European Community, Japan and the United States.<sup>a</sup>**

	Food	Agricultural raw materials
	Percentage by value	
EC	4.4	0.2
Japan	22.6	0.3
U.S.	2.6	0.2

<sup>a</sup>Figures are trade weighted averages of Most Favored Nation, General System of Preferences and other preferential tariffs.

Source: UNCTAD, *Protectionism and Structural Adjustment in Agriculture*, TD/B/939, Geneva, March 17, 1983.

**Nontariff** barriers to trade include many different kinds of measures. A classification published a few years ago identified almost 50 different kinds. Some of these clearly are intended to increase exports or to reduce imports. The European Community (EC), for example, uses a particular nontariff barrier called a **variable levy** for many agricultural commodities. Unlike a tariff, this levy changes frequently to ensure that imports do not enter EC at less than a fixed minimum price. Since the minimum price generally is above world prices, the levy insulates EC's agricultural producers from foreign competition.

It is extremely difficult to obtain numerical information on nontariff barriers. Furthermore, the ef-

fect of such barriers is hard to quantify. In some cases, it is even difficult to determine whether a particular measure is used to restrict competition. Health and safety standards, for example, may be established either for legitimate reasons or to discriminate against imports. Some measures may be used simply to offset the effects of the protective trade practices of other countries on import or export prices.

Table 2 provides information on the incidence of some of the major forms of nontariff barriers in a sample of industrial countries. Although the nontariff measures differ, in most cases, they influence a significant proportion of the agricultural imports of these countries.

Tariffs, nontariff barriers, domestic taxes and subsidies operate together to produce a level of protection for domestic industries. In discussing the size of protection, it is useful to distinguish between the nominal and effective rates of protection. The concept of **nominal** protection is relatively straightforward. It represents the degree to which the price received by the domestic industry for its product is above or below the corresponding world market price. Clearly, if the domestic price is above the corresponding world price (nominal protection is positive) then governmental policies are providing that industry with an advantage over imports. On the other hand, if nominal protection is negative, the policies apparently are putting the industry at a competitive disadvantage.

The concept of **effective** protection is comprehensive but more subtle than the concept of nominal protection. In the first place, it recognizes that an industry may be affected by governmental policies both through the product prices it receives and the input prices it pays. When these inputs are traded internationally, changes in their prices brought about by tariff or nontariff barriers should be taken into account. The effective rate also takes into account the magnitude of protection relative to an industry's value added. Stated simply, the smaller the difference between the industry's production costs and its revenue per unit (value added), the greater the significance for that industry of the price or cost advantage provided by protective governmental measures. For an industry

operating on a tight margin, protection can be an extremely important factor in survival.

Some estimates of nominal and effective rates of protection for processed agricultural commodities in EC, Japan and the United States are presented in Table 3. These figures show that in many cases the effective rate of protection provided by trade and domestic policies is considerably greater than the nominal rate of protection. This is particularly true in the case of dairy products that have extremely high effective rates in EC and Japan. Note, however, that in at least one case (processed corn in the United States) the effective rate is less than the nominal rate. The increased cost of inputs generated by protective policies more than offsets the small amount of protection provided for the industry's product. Where this occurs, a positive nominal rate of protection can be turned into a negative effective rate.

These tables demonstrate that protective policies influence many agricultural products, and that for some agricultural industries the size of protection is quite large. The question is, why is agriculture such a protected industry?

## Reasons for Protection

There are many reasons why agriculture is so heavily protected around the world. Most of them are domestic in nature. Through protection, governments attempt to achieve particular domestic objectives. Some of the most important of these objectives are:

- protecting national security;
- increasing producer incomes;
- stabilizing domestic markets;
- generating employment, improving the balance of payments or increasing government tax revenues; and
- protecting rural institutions.

EC, for example, uses a set of agricultural trade measures that help maintain internal prices for most commodities at high and stable levels. When EC was established in the late 1950's, its founding treaty identified security of supply and market sta-

**Table 2. Major nontariff barriers on food and beverage imports in selected industrial countries, 1981.**

Type of barrier	Country					
	France	Germany	Italy	Japan	U.K.	U.S.
	<i>Percentage of imports affected</i>					
Import licensing	11	14	1	9	—	38
Variable levies	40	39	44	—	44	—
Global quota	—	—	—	—	—	26
Country quotas	2	—	3	—	—	—
Other quotas	15	9	21	12	3	41
Other quantity restraints	22	—	4	—	—	—

Source: International Monetary Fund, *Developments in International Trade Policy*, Washington, D.C., 1982.

**Table 3. Nominal and effective rates of protection for processed agricultural commodities in the European Community, Japan and United States in the mid-1970's.**

	EC		Japan		U.S.	
	Nominal	Effective	Nominal	Effective	Nominal	Effective
	<i>Percentage by value<sup>a</sup></i>					
Meat products	33	165	18	69	6	10
Fruit and vegetables	45	75	19	49	15	37
Dairy products						
cheese	59	276	35	175	12	35
butter	77	1,328	45	418	10	47
Grain products						
corn	22	82	26	69	4	0
flour and cereal preparations	49	95	24	75	11	35
Soybean oil	148	148	25	268	23	253

<sup>a</sup>For the nominal rate, this is the percentage by which the domestic product price is above the world price. For the effective rate, this is the percentage by which protected value added is above the value added without protection.

Source: Yeats, A.J. "Agricultural Protectionism: An Analysis of its International Economic Effects and Options for Institutional Reform." *Trade and Development*, No. 3, Winter 1981.

bility as major agricultural policy objectives, in addition to the protection of producer incomes and improvements in productivity.

These objectives are reflected in the way that EC's trade policies function. A system of minimum import prices provides producers with stable prices above world market levels, and has resulted in a high degree of self-sufficiency in many agricultural products. Few would question the validity of EC's policy objectives. However, the level of support provided by its trade policies has helped turn the region into an exporter of many products. This has disrupted the export markets of other less protected producers. Unfortunately, protectionism can have many negative consequences both for the protecting country and for other countries.

## Protection and the Domestic Economy

Protection usually results in domestic prices that are different from world market prices. Many developing countries keep their domestic prices below world levels to protect domestic consumers. This increases consumption, acts as a disincentive for domestic production and increases dependence on imports. In most developed countries, agricultural producers are protected through prices that are substantially higher than those in world markets.

In general, for example, EC's minimum import prices for agricultural commodities are substantially higher than international prices. Those for sugar and dairy products usually are two to three times as great as world prices. Higher prices translate into increased returns for producers and others involved in the domestic production of protected commodities. They also translate into higher expenditures by consumers. Governmental revenues and expenditures also are influenced by protection. Depending on the kinds of policy measures used,

the government can either raise revenues from protection (for example, through tariffs) or incur expenditures (for example, through subsidies).

As an example of the redistributive effects of protection, Table 4 provides estimates of the size of the gains and losses incurred as the result of Japanese agricultural policies in the mid-1970's. In virtually all cases, these policies resulted in a positive transfer of income to producers, and certainly in the case of rice, this transfer was substantial. In contrast, consumers incurred a substantial additional cost as the result of higher prices. The Japanese government incurred additional expenditures for some commodities but raised revenue from others. The net effect was to increase governmental revenues.

These estimates illustrate that agricultural protection frequently redistributes income. Transfers of income to producers can be achieved by implicitly taxing consumers through increased product prices or through the explicit use of governmental revenue. The methods of protection employed will determine the size of the transfers involved and their pattern. The redistribution generated by protection often is a major political factor in preventing change. Some individuals have a lot to gain or to lose from changes in existing protective policies.

Protection not only redistributes income, but it usually implies a cost for the protecting country as well. Higher cost domestic production is substituted for lower cost world supplies. This diverts national resources from other activities into the production of the protected product and also reduces consumption. Estimates derived for the sum of such costs for major agricultural products in a sample of countries are given in Table 5. Obviously the absolute dollar amounts involved can be large. Relative to agricultural income, they also can be significant. However, in most richer countries the cost of protection relative to national income appears to be relatively small. This may be one reason why many de-

**Table 4. Estimated gains and losses from protection of Japanese agriculture, 1975-76.**

	Pro- ducers	Con- sumers	Government (taxpayers)
Million dollars			
Wheat	45	179	-226
Rice	5,012	-3,085	-2,012
Soybeans	22	-642	618
Barley	27	97	-139
Milk	384	-1,244	721
Pork	484	-1,765	1,191
Chicken	-82	-523	601
Beef	208	-1,042	786
Net gain or loss	6,100	-8,025	1,540

Source: Computed from Bale, M.D., "Distributional Aspects of Price Intervention." *American Journal of Agricultural Economics*, 61(1979):348-350.

veloped countries seem willing to protect their domestic agriculture even if this results in higher food costs for consumers, and in some cases, substantial governmental expenditures.

The cost estimates given in Table 5 probably understate the impact of protection since there may be significant spillover effects on other industries. Generally, protection represents an implicit tax on consumers. They have less income left with which to buy other goods. The producers of these goods may, therefore, be negatively affected. For example, the proportion of consumer income spent on food in the United States (including food away from home) is roughly 16 percent. In the protected market of EC, the corresponding figure is 22 percent. While some of this difference may result from dif-

**Table 5. Estimated costs of protection for major agricultural commodities in selected countries, 1976<sup>a</sup>.**

	Net cost of protection (million dollars)	Cost as percentage of	
		agricultural income	national income
France	337	2	0.1
Germany	516	4	0.1
U.K.	52	1	b
Japan	3,157	12	0.6
Argentina	388	8	1.0
Egypt	655	25	7.1
Pakistan	249	6	2.0

<sup>a</sup>Commodities included are wheat, corn, barley, sugar and beef.

<sup>b</sup>Less than 0.05.

Source: Computed from Bale, M.D., and E. Lutz, "Price Distortions in Agriculture and Their Effects: An International Comparison." *American Journal of Agricultural Economics*, 63(1981):8-22.

ferences in consumer preferences, much of it is the result of protection. These figures suggest that up to 6 percent of consumer income is being diverted to support agriculture in EC and is not, therefore, available to be spent on other goods.

## The International Implications of Protection

When a country alters its volume of trade through protectionist policies, implications for other importing or exporting countries are likely. This is particularly true if the protectionist country is a large producer or consumer of the product. When countries restrict their imports, this exerts a price-depressing effect on world markets. Exporters compete for a share of a smaller pie in the world market and prices are driven down. As a result, exporting countries lose because their earnings from exports decline. On the other hand, other importing countries gain if their imports cost less.

How much are world prices depressed because of trade barriers? The United Nations Conference on Trade and Development (UNCTAD) estimated in the early 1970's that prices of the most important foodstuffs in world markets were depressed on average by about 30 percent by international trade barriers.

Although many countries are highly protective towards agriculture, large and richer countries such as EC and Japan often are singled out for particular criticism because of the effects of their policies. EC has generated particular anger among other exporters. Its high support prices have contributed to a substantial increase in production and have turned EC into an exporter of subsidized products. Furthermore, the way in which the policies of EC and other protectionist countries function contributes to world price instability.

Trade barriers usually isolate domestic consumption and stocks from changes in world market conditions. If world prices fluctuate because of changes in world supply, the markets of protected countries such as EC largely are unaffected. They do not share in the shortrun adjustments necessary to stabilize world prices. Furthermore, many protectionist countries tend to export their domestic variability. As their domestic supply varies due to weather or other conditions, they simply vary their exports or imports to compensate. This allows the countries to maintain stable domestic prices and avoid the costs of keeping stocks, but passes the burden of adjustment to other countries.

Not all countries who protect their agriculture behave in this way. The United States provides its grain producers with support when prices are low. Surplus production is stored until prices rise and this helps provide a reserve to buffer supply fluctuations created by weather conditions at home or abroad. If protection means that a country builds up its stocks, then this may contribute to world market stability. However, it also will mean that world market prices on average will be lower than in the absence of protection.



## Reducing Protection

Economic theory suggests that trade unimpeded by protective barriers contributes to increasing the world's standard of living. Through trade, countries are able to make the most efficient use of their domestic resources and expand their consumption of goods and services. History has shown that trade can be a dynamic force for stimulating economic growth. Widespread protection prevents these benefits from being realized in agriculture.

Although not all may benefit from freer trade, the **collective** gains are likely to outweigh the losses. It may be possible for those who gain to compensate those who lose. Measures such as those that focus on the retraining and relocation of workers displaced by international competition deserve serious consideration. Furthermore, legitimate domestic objectives such as security of supply which underlie existing trade policies still can be achieved if protection is reduced. The challenge for our domestic and international institutions is how to reduce the barriers to agricultural trade in such a way that countries and individuals share the burden of adjustment, and receive a share of the benefits from freer markets.

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# Linkage Between U.S. Economic Policies and Agricultural Trade

Ag Trade 6

Bob F. Jones<sup>1</sup>

## Situation

In fiscal year 1972, agricultural exports were about \$8 billion. During the 1970's they expanded rapidly, peaking at \$43.8 billion in 1981. The volume of U.S. exports increased from 67 million metric tons (mmt) in 1971 to 164 mmt in fiscal year 1980. Higher prices accounted for the balance of the increase. Since 1981, agricultural exports have declined to about \$32 billion in 1985.

Farm costs continued to rise over the entire period, especially interest costs since 1979. This resulted from higher interest rates and use of larger amounts of credit as asset values inflated. Interest rates were at unprecedented levels during the early 1980's. With reduced demand for farm products and higher costs, agricultural profit margins were reduced sharply.

This combination of reduced profit margins and higher real interest rates led to declining asset values in agriculture, especially U.S. farmland prices. This has led to severe financial stress for a large segment of the agricultural sector. By the mid-1980's, agriculture was experiencing the most severe recession it had faced since the depression of the 1930's.

In a relatively short period (1972 to 1983), agriculture has gone through an expansionary phase in which (1) most of the land formerly held out of production under government programs came back into production, (2) machinery and other capital assets flowed freely into the farm sector, (3) land prices increased by more than 230 percent, and (4) many operators believed they could sell at a profit all the agricultural products that could be produced. Today, there is excess capacity and farm assets, and incomes are down.

What has caused such a rapid change in the agricultural situation in such a short period? How is the agricultural sector linked to the rest of the economy and to the world economy? How much of this linkage is under the control of the agricultural sector and how much is outside its domain, and therefore tends to severely buffet the agricultural sector?

## Linkages to General Economic Policy

During the 1970's, annual inflation rates rose from about 5.5 percent at the beginning of the period to a peak of 13.5 percent in 1980. Worldwide inflation rates followed a similar pattern. During this period, U.S. monetary and fiscal policies were expansionary. October 1979 signaled a major change in U.S. monetary policy. The major objectives of that change were to reduce inflation, reduce inflationary expectations and strengthen the value of the dollar. At that time the Federal Reserve changed from a practice of managing interest rates to managing the rate of growth of the money supply. Interest rates were allowed to fluctuate with changing market conditions. Nominal interest rates reached the 15 to 19 percent level in 1980 and 1981.

During this time the Consumer Price Index (CPI) showed an annual rate of increase of about 12 percent. The real interest rate (essentially the nominal rate minus the rate of inflation) was over 8 percent in 1981, substantially above the 0 to 1 percent rates experienced during the mid-1970's. Real rates were actually slightly negative in 1974 and 1975.

On the fiscal policy side, the Economic Recovery Tax Act of 1981 reduced the rate of growth of Federal revenue. This and the failure of Congress and Administration to reduce Federal expenditures produced Federal deficits that averaged \$160 billion from 1982 to 1984. The policy mix that emerged can be characterized as a "loose fiscal, tight money" policy that generated high real interest rates and a strong dollar in an open economy with flexible exchange rates.

It was necessary for the Federal government to finance from \$150 to \$195 billion of new debt each year because of the deficits. The amount of Federal borrowing contributed to the demand for loanable funds and helped keep nominal interest rates high. Some analysts consider Federal borrowing of this magnitude as "crowding out" private demand for funds. A large part of the Federal deficits was financed by inflows of capital from abroad. High rates of return in the U.S. financial markets generated demand from abroad for dollars, contributing

<sup>1</sup>Professor of Agricultural Economics, Purdue University.

to a sharp rise in the value of the dollar from its 1979 to 1980 low point.

All things equal, an increase in the value of the dollar has the same effect on exports as an increase in prices to the importer. The export sector of the economy is hurt as foreign buyers take fewer U.S. products. Imports into the United States become less expensive, and therefore, the volume of imports increases. Imported products become cheaper relative to domestically produced products. This generates competition for domestic industries and has been especially significant for autos, steel, textiles, shoes and some agricultural products, notably pork. This downward pressure on prices has helped keep inflation under control.

As U.S. exports declined and imports increased, the U.S. balance of trade experienced a deficit in 1977 through 1979 with a small surplus occurring in 1980 and 1981. Each year since 1981, the deficit has continued to grow. The balance of trade deficit for 1984 was over \$100 billion. The balance of trade component of the international accounts includes all exports and imports of merchandise and services as distinguished from capital flows and gold. Since the overall balance of payments accounts must balance, capital flows increased enough to offset the deficit in the balance of trade account. The balance of payments account must balance by definition and also because all imported goods must be paid for either by export earnings or accumulation of debt (capital flows). Actually, the deficit in the balance of trade account and the surplus in the capital accounts (inflows) are determined simultaneously. To argue otherwise is like arguing about which blade of the scissors is doing the cutting.

## Other Effects of Interest Rate Changes

An increase in the real interest rate increases the costs of conducting trade, especially in agricultural products. An increase in interest rates increases the costs of carrying stocks, and therefore, tends to cause prices to be lower as more of the commodity is placed on the market. Higher interest rates increase the cost of financing sales while commodities are en route to the buyer.

Likewise, higher interest rates raise the costs for production agriculture because of the time involved in most production processes. As more inputs are purchased from the nonfarm sector rather than being produced on the farm, capital requirements have increased. A combination of larger capital requirements per farm and higher interest rates has caused interest costs to comprise a much larger share of total production costs than was the case 20 years ago. As a consequence, agriculture is now more sensitive to interest changes that are determined by nonfarm market forces and national monetary and fiscal policy.

Higher real interest rates affect agriculture in still another way. Land prices are determined by the amount of income expected from it over time, the expected rate of inflation or deflation and the real rate of interest. Other things equal, the higher the real rate of interest, the lower the value placed on land through the capitalization process. During the 1970's, all three factors were positive forces in the land market. With changed monetary policy in the 1980's, all have had a negative impact on land prices.

## Other Considerations

Would a return to the set of exchange rates that existed in 1979 and 1980 restore the level of agricultural exports then existing and enable agricultural exports to grow at the rates observed in the 1970's? The answer to both questions, at least in the short run, is probably no. There is ample evidence that adjustment to changed exchange rates occurs with a time lag. Adjustment is not instantaneous but requires time to enable responses to the new level of exchange rates.

Factors other than the absolute level of interest affect the exchange rate. Rather, it is relative interest rates that are important, for example, a comparison of the rates in one country versus another. Considering other things equal, the country with the higher real rate of interest will likely have the stronger currency. Demand for a country's currency is also influenced by the political stability of the country. The United States is considered a "safe haven" for investment of funds. The extent and anticipated profitability of investment opportunities within the United States compared to investment opportunities outside is another factor in determining the exchange value of the dollar.

Besides relative exchange rates, other economic and political variables determine the level of U.S. agricultural exports. The following are key developments that influence the rate of growth of U.S. agricultural exports.

1. The rate of growth in economic activity in importing countries. In the early 1980's, most countries experienced slow rates of economic growth. Many of these countries complain about the impact of U.S. "tight money—loose fiscal policy" and the capital inflows that it generates. They see these developments as creating a drag on their economies. They argue that they have to keep their interest rates high to avoid even larger capital outflows. High rates of interest limit capital spending. These economies benefit, however, as exports expand because of more favorable exchange rates.

2. The debt-credit situation especially in Less Developed Countries (LDC's) and Centrally Planned Countries (CP's). Since the early 1960's, most of the growth in exports of U.S. agricultural products has occurred between the United States

and LDC's and CP's. Many of these countries, especially in Latin America and Eastern Europe, have accumulated such large external debts that a high proportion of their current export earnings is required to service accumulated debts. Inability to service debt and lenders' unwillingness to extend further credit severely limit their ability to import agricultural products regardless of the strength of their currency relative to the dollar.

3. Political relations. Several countries, especially in Eastern Europe, find it difficult to negotiate new loans from the West because of political considerations and their current debt situation described earlier.

4. Trade practices of other countries. Many countries place emphasis on other goals besides economic efficiency. They may limit imports because of balance of payments considerations, domestic agricultural programs designed to improve their farmers' incomes, the effects of imports on employment, or a desire for food self-sufficiency. They may put more emphasis on internal price stability and insulate their producers and consumers from external forces rather than permit prices to adjust to changing world market conditions.

## Is the Dollar Overvalued?

In the short run, the answer is no. Exchange rates between the United States and other trading partners are determined by market forces. Although there is some intervention from time to time into markets by governments of major countries, the present system is relatively free compared to earlier systems used for determining exchange rates.

A longer term perspective suggests the dollar is overvalued. A country cannot accumulate such large deficits in its balance of trade accounts indefinitely. With the large capital inflows that have been occurring in the 1983 to 1985 period, the United States has now become a net-debtor country for the first time since about 1917. If the Federal deficit continues to be as large as it was in the 1983 to 1985 period and the balance of trade continues to run such a large deficit, eventually exchange rates will weaken to bring the world trading system back into equilibrium. Exactly when this will happen is uncertain, but it is highly unlikely that such a state of disequilibrium as is occurring in the mid-1980's can continue for more than a few years.

## Summary

The search for a solution to the current price and income problems of U.S. agriculture needs to put emphasis on the links between the agricultural sector and the general economy. General economic policy that influences interest rates and the exchange value of the dollar has significant impact on the profitability of the sector by affecting its ability to export agricultural products, its cost structure and the value of assets used on agricultural production. With such a large proportion of production entering the export market, U.S. farmers have a vital interest in U.S. monetary and fiscal policies because of the effects they have on their competitive position in trading relationships. These policies lie outside traditional agricultural policy and probably have as much or more impact on farmers' well-being than traditional policy concerns.

This publication is based on a presentation given by Robert Chambers, The University of Maryland, as a part of a televideo conference, "Agricultural Trade Policy Under Scrutiny", produced by Earl H. Brown, professor, The University of Maryland, and Luther Tweeten, professor, Oklahoma State University, on March 19, 1985. Sponsorship and funding were provided by: Extension Task Force on Agricultural Trade; Extension Service, USDA; Farm Foundation; and National Center for Food and Agricultural Policy.

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# The Effect of the 1985 Farm Bill on U.S. Wheat Trade

Ag Trade 7

Earl H. Brown and Andrew Schmitz<sup>1</sup>

The U.S. wheat industry has been in substantial oversupply for at least 6 years. One objective of the 1985 Farm Bill was to increase wheat exports by decreasing price, increasing promotion and using targeted subsidies. The success of these efforts depends largely on the willingness of importing nations to buy additional quantities of wheat at lower prices and the effectiveness of counter measures taken by other wheat-exporting countries, especially Canada, Australia, Argentina and the European Community. Evidence shows that the export demand for wheat, at current and lower prices, may not be as responsive to price as previously thought. Additionally, other exporting countries have acted aggressively to maintain, and even increase, their market shares by countering actions taken by the United States.

## Agricultural Situation

The major problems facing agriculture when the 1985 Farm Bill was being forged were: declining exports, growing surpluses, low farm prices and income, large government costs and increasing farm debt.

Agricultural exports declined from \$43.8 billion in 1981 to \$31.2 billion in 1985. The latest forecast for 1986 is \$26.5 billion. Several factors contributed to this decline. The worldwide recession lessened demand, a strengthening dollar made purchases more expensive to other countries, greater production in other countries took away U.S. markets, and the grain embargo caused importers to look elsewhere. World prices fell below U.S. support levels and large quantities of some commodities were diverted from export to government storage.

Surpluses increased dramatically between 1981 and 1985. They were especially large for wheat, dairy products and corn, also for cotton, rice, oil seeds and tobacco. For example, yearend stocks of wheat increased from 78 million metric tons (mmt) in 1981 to 116 mmt in 1985, an increase of nearly 50 percent.

Lower exports and larger surpluses had two serious consequences. They caused farm prices and income to decrease and the cost of government price and income support programs to increase. The index of prices received by farmers for all crops decreased from 134 in 1981 to 121 in 1985. Net farm income, adjusted for inflation, fell from \$32 billion in 1981 to \$27 billion in 1985, a decrease of almost 16 percent.

The government cost of commodity price and income support programs reached a record \$18.9 billion in 1983, not including the cost of the 1983 PIK program. This was a substantial increase from the approximate \$3 billion per year cost from 1977 to 1981. Government costs decreased somewhat in 1984, but went up to \$18.3 billion in 1985. These large costs appeared especially burdensome in light of the large Federal deficit in 1985.

A substantial portion of the U.S. farm sector was under severe financial stress. About 7 percent of farmers had a debt to asset ratio over 70 percent. An additional 11 percent had over 40 percent debt. The situation was the most serious on grain farms in the Midwest and among farms with over \$250,000 sales per year. Bankruptcies were increasing among farmers, rural businesses and small banks with relatively large portfolios of agricultural loans. The farm credit system was in trouble.

Perhaps the agricultural situation would have been bearable in 1985, except there appeared to be very little possibility for improvement. The Reagan administration wanted to reduce the cost of government programs and move agriculture towards a more market-oriented system. Farm organizations, farm state legislators and the administration were under considerable political pressure to rescue agriculture. This was the stage for negotiating the 1985 Farm Bill.

## Wheat Situation

During the last 6 years, wheat production exceeded use by a substantial margin. Stocks grew from 989 million bushels in 1980 to 1,900 million bushels in 1986. Production decreased only slightly from 2,765 million bushels in 1982-83 to 2,425 mil-

<sup>1</sup> Professors, The University of Maryland and University of California, respectively.

lion bushels in 1985-86 in spite of harvesting 13 million fewer acres. Domestic use for livestock feed increased substantially as a result of lower prices. The increase, however, was not enough to offset a sharp decrease in exports, from 1,514 million bushels in 1980-81 to 915 million bushels in 1985-86, a decrease of 599 million bushels, or 40 percent. Average price received by farmers fell from \$3.91 per bushel in 1980 to \$3.16 per bushel in June 1986.

U.S. wheat production in 1986 is forecast at 2.2 billion bushels, down over 250 million bushels from last year, mainly as a result of harvesting fewer acres in response to the set-aside provision of the 1985 Farm Bill. World import demand is expected to increase about 150 million bushels. The new U.S. loan rate, which became effective June 1, 1986, should permit U.S. prices to be more competitive in world markets. This, with some further weakening of the dollar, has caused the USDA to forecast an increase in exports of 235 million bushels. Stocks should decrease slightly, but farm price is not likely to exceed \$2.50 per bushel.

## **The 1985 Farm Bill**

The principle objectives of the 1985 Farm Bill were to increase agricultural exports, decrease surpluses, increase farm income and reduce production.

The basic commodity provisions of the 1981 Farm Bill (target prices, loan rates, deficiency payments and acreage reduction) were continued in the 1985 bill. The major differences are: target prices are scheduled to decrease over the life of the bill; loan rates will be tied to a moving average of past market prices, and acreage reduction programs are required when stocks exceed specified levels. A new feature is a conservation program which is designed to remove 40 to 45 million acres of marginal land from production more or less permanently. Lower price supports and a herd buy-out program are features designed to reduce both the number of dairy farmers and the number of milk cows.

Specifically for wheat, minimum target prices are \$4.38 per bushel in 1986 and 1987, \$4.29 in 1988, \$4.16 in 1989 and \$4.00 in 1990. The loan rate for the 1986 wheat crop is \$2.40 per bushel. For the 1987-90 crops, loan rates will be between 75 and 85 percent of the simple average of market prices during the preceding 5 years, after omitting the highest and lowest years. Reductions in loan rates will be limited to 5 percent per year, except the Secretary of Agriculture is authorized to reduce the loan rate up to 20 percent, as he did in 1986, in any year the average market price in the previous marketing year was less than 110 percent of the loan rate, or if a reduction is necessary to be competitive in the world market.

The deficiency payment for wheat is equal to the target price minus the higher of 1) the national average market price received by farmers during the first 5 months of the marketing year (entire year when the additional reduction is in effect); or 2) the loan rate prior to any discretionary reduction.

There are two kinds of acreage reduction provisions for wheat: an acreage set-aside, and a paid diversion. The set-aside for any year depends on the

level of stocks, and the diversion acreage may be paid with surplus stocks or cash.

The bill required the Secretary of Agriculture to conduct a poll of eligible wheat producers by July 1, 1986 to determine if producers would support mandatory production quotas. Over 50 percent of wheat farmers voted in favor of quotas, but the Secretary has said he will not abide by the vote. If quotas were implemented, the minimum national average loan rate would be the higher of \$3.55 per bushel or 75 percent of the average cost of production per bushel, excluding management and risk. The minimum target price would be the higher of \$4.65 per bushel or 100 percent of the average cost of production.

The major provisions of the 1985 Farm Bill designed to increase exports, in addition to lower loan rates are:

1. Use of surplus stocks to counter or offset adverse effects of subsidies, quotas and unfair trade practices of other countries, and to encourage the development and expansion of export markets for agricultural products.
2. Provision of export credit guarantees to eligible countries.
3. Authority to issue export certificates to producers as an incentive to increase exports.

## **Evaluation of the 1985 Farm Bill**

It is too soon to determine the long-range impact of the 1985 Farm Bill. However, the discussion which follows raises some serious questions about its effectiveness, especially in the short run.

### **Supply and Price Response by Other Exporters**

There are several major players in the world wheat market. The United States is the largest wheat exporter, with about 40 percent of the world market. There are two major sets of exporters who compete with the United States: (1) Canada, Australia and Argentina, who respond to world forces by essentially paying their producers a world price, and (2) EEC which pays its producers a price well above the world export price. What is their response to the lower loan rate and export promotion features of the 1985 Farm Bill likely to be?

Production in the EEC probably will not be curbed as a result of lowering the loan rate under the 1985 Farm Bill. What is likely to happen is that the EEC will merely increase export subsidy payments in order to avoid a buildup of domestic stocks. The USDA (August) is forecasting no change in EEC wheat production from 1985-86 to 1986-87.

In terms of the other three competitors, there is a strong indication that the Farm Bill will not affect acreage planted nor the amount of fertilizer use. In fact, acreage may increase. For example, in Canada there was a record planting of 35.1 million acres of wheat in 1986 and only a slight reduction in fertilizer use of 2 percent. As a result, production is likely to be down very little if at all. However, it is interesting to note that, in certain regions of the prairie grain sector, fertilizer use actually increased. In areas where fall and spring reserve

moisture was adequate, fertilizer use was up whereas, in the drier areas of the prairie region, fertilizer application fell. What this suggests is that in the short run fertilizer application depends more on moisture than it does on factor-product price relations. As of July 15, 1986 the United Growers forecast Canadian production of all grains to be a record 50 mmt in 1986. Record wheat production also is expected.

In Australia and Argentina, there does not appear to be a significant planned reduction in output either because of the 1985 Farm Bill. For example, in 1980-81, Australia planted 11,283,000 hectares of wheat; in 1982-83 plantings were 11,520,000 hectares, while in 1985-86 the forecast is for 11,959,000 hectares (Bureau of Agricultural Economics Quarterly Review of the Rural Economy). The USDA (August) forecast a slight decrease in Australia's wheat production in 1986-87 from 1985-86. But the USDA predicts a substantial increase in wheat production in Argentina from 8.5 mmt in 1985-86, to 9.6 mmt in 1986-87.

The International Wheat Council reported in June 1986 that despite lower world prices, growers in general do not appear to be considering significant reductions in planting. The evidence we examined supports this conclusion.

It is too early to determine if Canada and Australia will provide deficiency payments to producers in response to the Farm Bill. If they do, the export price subsidy war in wheat will heighten as these countries join the EEC and the United States. In Argentina, the government has taken steps to reduce its export tax on wheat. This has the effect of softening the price reduction to producers.

In terms of price competitiveness in world markets, Canadian officials contend that they have no choice but to compete with the United States on price. That is, if the United States exports wheat at \$2.50/bushel, Canada will meet the price. This appears even more likely to be the case in view of Canada's large 1986 wheat crop. In this case, it will be difficult for the United States to increase market share. This observation becomes even more important in view of the late July discussions by the U.S. officials to increase subsidies even more to the USSR and China.

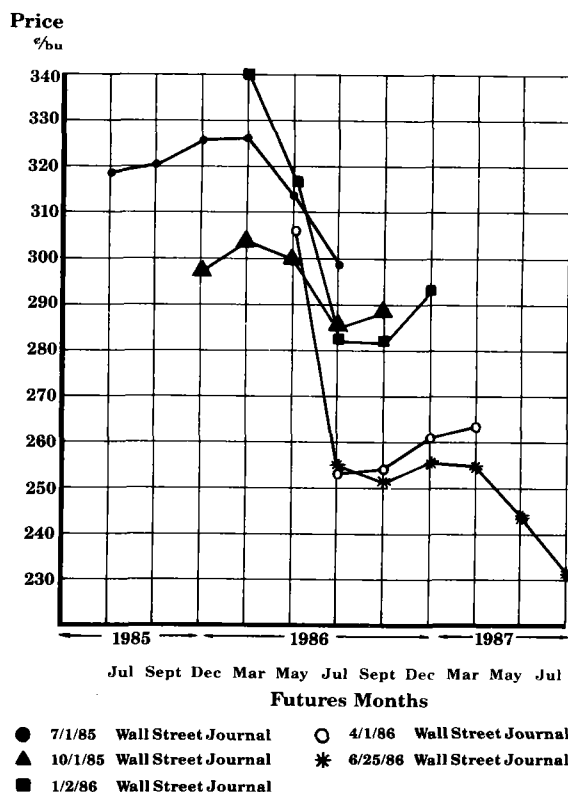
## Wheat Prices

If futures markets are indicators of future trends, as many economists argue, the 1985 Farm Bill certainly does not seem to add any strength to prices. As indicated in Figure 1, futures prices have continued to fall since passage of the 1985 Farm Bill. In addition, futures prices fell in anticipation of the provisions of the bill. One would expect that in the long run (such as after a year has elapsed) prices would start to strengthen if, in fact, exports increase sharply shortly after lowering the loan rate. However, the futures data do not indicate that this will be the case. Distant future prices are not significantly above the loan rates.

## Export Movement and Stocks

Table 1 gives data on both total export movement from the United States and stocks. As indicated by

**Figure 1. Chicago wheat futures prices**



the data, there has not been a significant movement projected for physical exports of wheat. On the contrary, the export forecast of 1.15 billion bushels for 1986-87 is well below the 1.5 billion levels for 1980-81 and 1982-83. In addition to the above, exports have been dropping in recent months. For example, exports in February 1986 were 77.6 million bushels compared to only 73.7 million bushels in March 1986. Exports fell further to 48 million bushels in May 1986, but rebounded to 81 million bushels in June and 121 million bushels in July. Outstanding sales as of July 1986 were 172 million bushels compared with 143 million bushels in July 1985, an increase of 20 percent. Total commitments (exports plus outstanding sales) in July 1986 were 293 million bushels compared with 207 million bushels in July 1985, an increase of 40 percent. Exports must average 95 million bushels per month for the next 10 months to reach the USDA forecast of 1,150 million bushels for 1986-87, which is 25 percent above the 1985-86 level. Even if exports reach this level, which is unlikely, stocks will remain virtually unchanged. If exports rebounded to the 1984-85 level of 1,400 million bushels, it would still take several years to reduce stocks to a manageable level. Therefore, at least in the next 1 to 2 years the export features of the 1985 Farm Bill will not increase exports enough to solve the large stocks problem.

## Conclusion

Some estimates suggest that the demand for wheat facing the United States from abroad is price inelastic. If this is true, a reduction in price brought about by the loan rate would not increase physical

**Table 1. Wheat situation and outlook<sup>a</sup>**

	1980-81	1982-83	1985-86 (Preliminary)	1986-87 (Projected)
	(millions)			
Acres harvested	71	78	65	—
Acres set aside	—	6	19	—
	(bushels per acre)			
Yield	33.5	35.5	37.5	—
	(millions of bushels)			
Production	2,381	2,765	2,425	2,164
Beginning Stocks	902	1,159	1,425	1,900
Supply	3,286	3,932	3,864	4,064
Domestic Use	783	908	1,085	1,077
Exports	1,514	1,509	915	1,150
Ending Stocks	989	1,515	1,900	1,845
	(average price (\$) per bushel)			
Price	3.91	3.55	3.16	2.37

<sup>a</sup>Source: USDA (August 1986).

exports proportionately. Thus, the increase in export tonnage would result in a decrease in the value of wheat exports. The data seem to support the inelastic nature of the excess demand curve facing U.S. wheat at least in the short run; also, there are many factors which could bring about this inelastic situation.

As suggested previously, because of the nature of response by competitor exporters, a lowering of the loan rate could simply mean that other countries lower their price in competition with the United States. As a result, it is difficult for the United States to increase its market share and reduce stocks because of the competition from other exporters. In addition, many importers insulate their economy from the world market. For example, the Japanese charge their millers a price at least three times above what the wheat agency pays for wheat from the United States. Therefore, a lowering or raising of the export price to the Japanese only means that the Japanese government either increases or decreases its revenues from transactions. A lower U.S. price does not get transferred to consumers. This is also the case in Egypt where their internal prices are actually subsidized. Therefore, lowering prices to the Egyptians will not necessarily stimulate an increase in demand unless this price would actually fall below their internal subsidized price.

The international transmission price elasticities for many regions are extremely low. What this means is that, even if prices are significantly reduced in the export market, they do not necessarily get transferred into lower prices for the consumers.

In June 1986, the situation seemed to be getting worse for U.S. exports. Concern was expressed when, for the first time in recent history, the net U.S. trade balance for agriculture was negative. On July 11, 1986, the Wall Street Journal reported "farm state lawmakers and their constituents are pressur-

ing the Reagan administration to bolster agricultural export programs as the U.S. farm trade picture darkens further." However, the USDA already had raised its estimate for fiscal 1986 grower subsidies to \$25 billion from \$17.8 billion last year. Some estimate that even a \$30 billion cost is too low. Substantial additional help seems unlikely.

Dissatisfaction over the 1985 Farm Bill to generate export sales has revived interest in production controls. Growers in Nebraska and Oklahoma support production controls while others in the Pacific Northwest do not. Production controls may be the only choice unless the United States is willing to support producers by providing larger deficiency payments. The size of these payments depends on the nature of the international demand facing the United States. The data suggest that demand may be price inelastic which makes the 1985 Farm Bill a costly program.

Export cooperation among the major exporters could solve the current crisis. All exporters would have to reduce subsidies and production. This type of solution was discussed in June in Vancouver, Canada, by high level government officials from major exporting countries. However, in view of the recent proposal by the United States to increase further export subsidies, the success of the meeting is questionable. This does not imply, however, that efforts to bring about export cooperation have ceased.

The U.S. Farm Bill has added a major concern about U.S. trade with its close allies. For example, the United States and Canada have been negotiating a free trade agreement. However, with the U.S. Farm Bill, Canadian agricultural interests have greatly opposed free trade between the two nations since the cost to Canadian producers, due to lower prices as a result of the bill, far outweighs the potential gains from freer trade in agriculture between the two countries.



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