

**Fourth Minnesota Padova Conference on
Food, Agriculture, and the Environment**

Proceedings of a Conference Sponsored by
University of Minnesota
Center for International Food and Agricultural Policy

Universita degli Studi di Padova
Dipartimento Territorio e Sistemi Agro-forestali

Regione Veneto

Ente di Sviluppo Agricolo

**SESSION I: RECONNAISSANCE OF AGRICULTURAL AND
ENVIRONMENTAL POLICY DEVELOPMENTS:
U.S. AND E.U., NAFTA, AND GATT**

**PAPER 3: AGRICULTURAL TRADE ISSUES AND THE
1995 FARM BILL**

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Spring Hill Conference Center, Wayzata, Minnesota
September 4-10, 1994

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Agricultural Trade Issues and the 1995 Farm Bill*

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*Paper presented at the Fourth Minnesota\Padova Conference on Food, Agriculture, and the Environment, sponsored by the Università degli Studi di Padova, Dipartimento Territorio e S.A.F., Sezione Estimo e Diritto, Italy, and the Center for International Food and Agricultural Policy, University of Minnesota, St. Paul, Minnesota, U.S.A. September 5-8, 1994, Wayzata, Minnesota. This paper also appeared in Extension Farm Bill Base Book, "Agricultural Trade Policy," National Public Policy Education Committee. College Station, TX: Texas A&M University. 1994.

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Background

The 1995 farm bill will be written to a backdrop of complex, and often conflicting, trade issues. Completion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), issues related to the North American Free Trade Agreement (NAFTA), and the prospects for extending preferential trading status to other Latin American nations may all be important issues affecting the outcome of the debate over a new farm program.

The 1990 farm bill contains provisions to continue export price subsidies, credit guarantees, nonprice promotion, and food aid. Export price subsidies and credit guarantees are discussed here, while export promotion and food aid are addressed in other leaflets.

The Export Enhancement Program (EEP) was authorized under the Food Security Act of 1985 and has become the primary means by which the United States has attempted to meet price competition in world markets when domestic policies supported prices above the world market or to counter subsidies used by foreign competitors.

Since its inception in 1985, the EEP has been used to subsidize export sales to over 84 countries. By early 1991, over 106 million tons of wheat and wheat flour, 10 million tons of barley, 319,000 tons of grain sorghum, 327,000 tons of rice, 189,000 tons of poultry feed, 207,000 tons of poultry, 788 million eggs, 874,000 tons of vegetable oil, and 70,000 head of dairy cattle had been sold under provisions of EEP. Total EEP sales have exceeded \$13.9 billion. In early 1992, USDA began paying EEP bonuses in cash.

Export credit guarantees have been used to support U.S. commercial agricultural exports to countries that might not otherwise be able to buy U.S. products and to counter credit and price competition by other exporters. Credit guarantees increase the availability of credit at reduced interest rates to foreign customers.

Current Situation and Forces for Change

Uncertainty regarding world markets and foreign competition has prompted the United States to rely increasingly upon programs designed to enhance trade. Throughout the 1950's and the 1960's, government-supported trade programs accounted for over 20 percent of all U.S. agricultural exports in most years. The 1970's witnessed a decline in government supported export sales to below ten percent of total agricultural exports. The mid-1980's brought greater competition, stockpiling of commodities, and lower prices, while the early 1990's were characterized by increasing tensions in the multilateral trade negotiations and global recession. These forces caused a resurgence in government supported export sales. In FY92, for instance, over one-fifth of U.S. agricultural exports were supported by some form of government program.

To counter unfair foreign competition and to offset the effects of declining exports, the U.S. Congress increased funding for price-reducing export programs beginning in 1986. The EEP has expanded from \$350 million in FY86 to \$1.0 billion in FY 89. Since then, budgetary pressure has forced reductions in EEP funding to \$525 million in FY92. Congressional authorizations require that the Commodity Credit Corporation (CCC) make available at least \$1.0 billion annually in cash or commodities to support EEP sales through FY95.

The CCC export credit guarantee program includes \$5.0 billion annually in short-term credit, \$500 million for intermediate credit, and \$200 million in guarantees for emerging democracies. For FY95 it is estimated that the total government cost of export programs will be \$8.4 billion, compared to \$8.8 billion in FY94.

Major provisions of the Uruguay Round agreement will force changes in these export promotion programs. Among the mandated changes resulting from the GATT Round are a 20 percent reduction in aggregate internal support considered most trade distorting; the conversion of existing trade barriers to tariffs and subsequent reductions of 36 percent overall; minimum market access guarantees; 36 percent cuts in expenditures on export subsidies and 21 percent cuts in subsidized export volumes; a set of "principles and guidelines" for sanitary and phytosanitary measures; and a "peace clause" exempting domestic agricultural subsidies from most GATT challenges, although countervailing duties would still be possible (Sanderson).

The General Agreement on Tariffs and Trade: How Will the U.S. Adjust?

Although agreement has been reached in the Uruguay Round of GATT, it appears unlikely that trade tensions will subside prior to the implementation of a new farm bill. The GATT agreement, despite its extraordinary complexity and difficulty in negotiation, is unlikely materially to affect U.S. agriculture in the short run. If approved by the U.S. Congress, over the medium to long run (10-15 years), it is likely to establish a world trading regime that will amplify and reward many U.S. advantages in agricultural competitiveness.

What changes will be necessary in U.S. farm programs? The overall internal support cut of 20 percent in the Aggregate Measure of Support (AMS) is wide enough in scope to allow certain protected commodities (e.g., sugar) to remain entirely unscathed. Direct or "decoupled"

payments are exempted from reductions. Moreover, when the 1986-88 base used to calculate the 20 percent cuts is applied, many U.S. commodities are already "paid up" and in compliance. From the point of view of U.S. farmers this adds up to little or no impacts. Domestic support may actually increase if decoupled, non-trade-distorting payments are the recipients of funds previously earmarked for export promotion. One candidate for such funds would be conservation-related or "green" payments.

The market access agreements, calling for "tariffication" of border measures, will make protection more "transparent." This tariffication will apply to various U.S. laws, including Section 22 of permanent agricultural legislation, as well as the U.S. Sugar Act, and the Meat import Law. From the point of view of consumers, importers and exporters how much tariffs will actually fall (under the 36 percent reductions called for) depends on where tariff equivalents (TEs) are initially set. Canada, for example, has interpreted its initial tariff equivalents for "supply controlled" commodities very generously: 280-350 percent on dairy, 180-280 percent on poultry, 192 percent on eggs, and 93 percent on margarine. In Japan, the initial tariff on rice, to take effect in 2000, will be 500-600 percent. In addition, countries are allowed to change support measures from border protection to decoupled internal payments if they wish, creating the decoupled and/or green payment option mentioned above. Finally, "special safeguards" are allowed to prevent import surges by establishing additional duties. Overall, the impact of the market access agreement on consumers, importers and exporters will tend to take hold only after 5-10 years, and then with only modest impacts.

Export subsidy cuts, which will be 36 percent in value and 21 percent by volume, are perhaps the most significant achievement of the negotiation, and promise to somewhat reduce the excess of European Union export restitutions. This will translate, it is hoped, into budget and thus taxpayer savings on both sides of the Atlantic. In quantitative terms, the agreement obligates the EU to reduce its subsidized wheat exports from 20.2 million metric tons to 13.4 million metric tons, and its feedgrain exports from 12.7 million metric tons to 10 million metric tons. This will result in additional opportunities for other exporters; the U.S. is likely to gain markets for feedgrains, while Australia and Canada pick up the lion's share of additional wheat exports (see Figures 1 and 2).

The "principles and guidelines" for sanitary and phytosanitary measures are an important step toward confronting nontariff barriers in agriculture but are only the beginning of a long and vexing process.

The "peace clause," much heralded in the EU as an indication of its negotiating prowess, probably has more of a psychological effect than a substantive one, creating an international sense that the export subsidy wars are over, at least for the time being.

One of the major questions surrounding the conclusion of the GATT talks is whether they were a catalyst which promoted unilateral reforms in the U.S., EU and Japan, or simply a ratification of these reforms *ex post facto*. This topic will be debated by trade specialists for years to come, and has no definitive answer.

A final dimension of the trade reform discussion in agriculture is its likely impact on environmental quality. A variety of studies have suggested that the greater the move to decoupled price supports, the more favorable the environmental impacts of agriculture. In so

far as the GATT agreement leads to greater decoupling, it will therefore allow moves away from mono-cropping as a response to crop-specific price supports.

In the final analysis, the GATT Agreement on Agriculture is a modest but important achievement, not least because it cleared the way for the larger negotiation (involving 14 other areas) to be settled successfully, with anticipated benefits to world income in excess of \$200 billion dollars. For U.S. farmers, it inflicts little pain in return for modest export gains; for protected commodities such as sugar or dairy, it offers scope for escape from many of its disciplines. As major exporters, U.S. feedgrain producers and processors will probably benefit most; U.S. consumers and taxpayers will see modest gains from increased market access and reduced budget expenditures. Finally, environmental improvements may be associated with the trend toward decoupling.

The Export Enhancement Program

The EEP faces the prospect of significant reduction in order to comply with GATT obligations. Although many farm and commodity groups argue that the U.S. administration has agreed to simply roll EEP funding into MPP, it now appears there will be a serious attempt to reduce overall funding for export programs. Even so, EEP still has support among policy makers and farm groups and after complying with GATT could still be funded at nearly \$500 million annually. EEP reductions under the GATT are shown in figures 1 and 2 for wheat and poultry, respectively. By the year 2000, U.S. expenditures on wheat exports must be reduced to no more than \$368.8 million, while subsidized tonnage must be reduced to 14.8 million tons. For poultry, the reductions are to \$14.6 million and 28,000 tons.

Some observers argue that EEP has been largely ineffective, displacing U.S. commercial

sales, transferring gains to foreigners, causing the U.S. to import more wheat than it would if the program did not exist, and instead of countering exports by the European Union (EU), only antagonizing strong allies and trading partners, Australia and Canada. Even after GATT provisions are fully implemented in the year 2000, EEP will likely remain a controversial program.

Export Credit Guarantee Programs

Since 1956 the United States has used various forms of direct credit and credit guarantees to stimulate the sale of U.S. agricultural products to developing countries. Administered by the CCC, export credit guarantees are U.S. government assurances for U.S. banks and businesses against default or failure of a foreign bank or government. USDA presently has two major programs: (1) the GSM-102 (General Sales Manager) short term credit program which guarantees credit up to three years and (2) the GSM-103 intermediate credit program which is a four to ten year credit guarantee. The primary objective of the GSM programs is to provide credit guarantees in order to expand or maintain U.S. exports in selected markets. Before 1989 defaults had been rare and actual government outlays under this program had been minimal. During FY86-FY88, for example, bank claims against obligations under GSM average about 12 percent. Since then, however, Iraq and several former Soviet states have become delinquent on loans, resulting in higher costs to the U.S. government and taxpayers.

Major GSM recipient countries in FY91-93 included Mexico, Korea, Algeria, Colombia, Chile, Pakistan, Venezuela, Romania and Russia. Products exported under these programs included grains, fruits, poultry, vegetable oils, meat, hides and skins, protein meals, dairy products, wood products, nuts, and livestock.

Policy Alternatives and Consequences

As public funds to support agriculture continue to shrink, it will become more important to determine which programs offer the highest and best use of public monies and the extent to which public and private interests gain or lose from changes in various export market programs. The purpose of this section is to highlight some of the considerations for government export programs and discuss their potential impacts on selected economic agents.

The Export Enhancement Program

The use of EEP has become quite important for some commodities. In 1992, for instance, EEP support as a share of U.S. wheat export sales exceeded 60 percent. Who gains and who loses from such policies is a source of much concern and controversy. The continuation of the EEP at current levels would likely have the following consequences.

U.S. farmers are targeted as the main beneficiaries of the EEP. However, much of the evidence does not support this contention. Whether or not EEP raises farm prices depends upon several observable events. First, U.S. prices can be expected to rise if EEP causes importers to increase their purchases of goods from the United States. But releasing government stocks in the form of an EEP bonus can depress farm prices in the short term. Which force prevails depends upon whether the increase in demand for U.S. goods under EEP exceeds the increase in market supplies. If so, prices will rise. If not, prices will fall. Farm prices are likely more unstable due to the stock reductions associated with EEP.

It has been estimated that during the first years of the program(FY86-FY89), only 10 percent of U.S. wheat sales under EEP were in addition to export sales that would have been made without EEP at higher, commercial prices (Paarlberg). Hence it is unlikely that the EEP

was responsible for the higher prices experienced in later years and most likely led to actually lower prices in the near term. Foreign consumers were major gainers from EEP as slightly higher purchases were made at much lower prices.

Private trading firms which source, store, condition, blend, handle, and transport grain are likely gainers from EEP. As sales are made, stocks are lowered and volumes traded increase. Private agribusiness firms, therefore, end up handling slightly more volume with an EEP than without.

Some benefits of EEP also accrue to rural communities, particularly those which have grain storage and rail facilities; they end up handling additional volumes of grain and experience some gains as trade is expanded. If demand for EEP exceeds supplies marketed, those same communities may also benefit from higher farm prices as increased plantings of program crops stimulate demand for farm inputs such as seed, fertilizer, and other products.

Consumers in the United States may actually benefit marginally from EEP in the short term as government stocks are dumped on the market and prices decline. However, it is unlikely that these impacts will be extended or of great magnitude since most commodities, such as wheat for instance, comprise such a small share of the value of the final good produced. In fact, it can be argued that if EEP is effective at actually raising prices, consumers could potentially lose as prices for flour, bread and other products rise.

EEP impacts on government costs depend upon the relationship between storage costs and farm prices. EEP potentially can reduce costs associated with government storage of grains as sales are made and stocks are lowered. However, if farm prices decline due to a release of government stocks, then deficiency payments may actually increase, thereby raising government

costs. If the reduction in storage costs exceeds the increase in deficiency payments, then there will be a net benefit to the government from the EEP program.

It has also been argued that EEP restored the price competitiveness of U.S. grains in the mid-1980's. While this may have a certain intuitive appeal, the empirical evidence suggests otherwise. Paarlberg has estimated that during the period 1985-87, 305 million bushels of wheat were exported under EEP at an average government cost of \$4.08 per bushel. The average Gulf export price during this same period was \$3.16 per bushel. He concludes that the government could have saved \$.92 per bushel by purchasing the wheat at the market price and destroying it. While EEP may result in lower prices to foreign buyers and restore U.S. price competition, this example raises a serious question about the cost of regaining that competitive advantage.

EEP also has been said to invite complaints from trading partners and allies, such as Australia and Canada because it lowers world prices and squeezes farm profits in other countries. EEP invites public image problems, may invite retaliation from competitors or trigger a trade war, and may have undermined U.S. efforts for trade liberalization in the GATT.

The Export Credit Guarantee Program

Export credit guarantees have had positive impacts on U.S. farmers by increasing the demand for U.S. agricultural products and resulting in greater exports than would have occurred without the program. Export credit promotes long-term market development and allow U.S. products to be more competitive.

Agribusinesses are beneficiaries of export credit programs. As credit is extended and exports increase, agribusinesses, especially private trading firms, experience an increase in volume of business. In most cases, export sales made under the GSM programs are in addition

to exports which would have occurred without the program and result in significantly greater trade volume for some firms.

Rural communities may benefit from GSM, particularly if grain and processing facilities are located nearby and experience greater business volume as exports increase. Allied industries such as fuel, power, building construction, transportation, and banking may also gain.

If export credit guarantees increase sales substantially above historical levels, farm prices will rise. In some cases these higher prices will result in consumers paying slightly more for some food or fiber products. The magnitude of the price increase to consumers depend upon the extent to which bulk or processed products are exported under GSM. Bulk commodity price increases are less likely to be passed on to consumers than increases in final goods prices.

The amount of government exposure under GSM depends on several key factors. GSM programs encourage U.S. banks to finance exports at commercial interest rates to countries which would otherwise not qualify for such loans. As the credit programs have grown to exceed \$5.0 billion in most years, default by foreign bank or government has become more important as U.S. government exposure has increased. However, if export credit is effective at increasing exports and raising farm prices, then deficiency payments to farmer would be expected to decline as market prices rise, hence government outlays to farmers would decline. The net government exposure under GSM depends upon whether or not reductions in deficiency payments to farmers exceed potential loan defaults by foreign banks.

Summary and Conclusions

The EEP will experience major reductions in funding support as a result of the Uruguay Round of GATT. The extent to which government savings on EEP are channeled into other

export programs, such as market promotion, export credit, or decoupled domestic support, remains to be determined. Both programs have positive and negative impacts as discussed above. The beneficiaries of those impacts will likely be focal point of the farm bill debate. Producers, agribusinesses, and rural communities all have a stake in the outcome of the debate on redirection of funding for market promotion. Impacts of export credit on these same economic agents is positive, with taxpayers facing some additional exposure if the prospects of default increase.

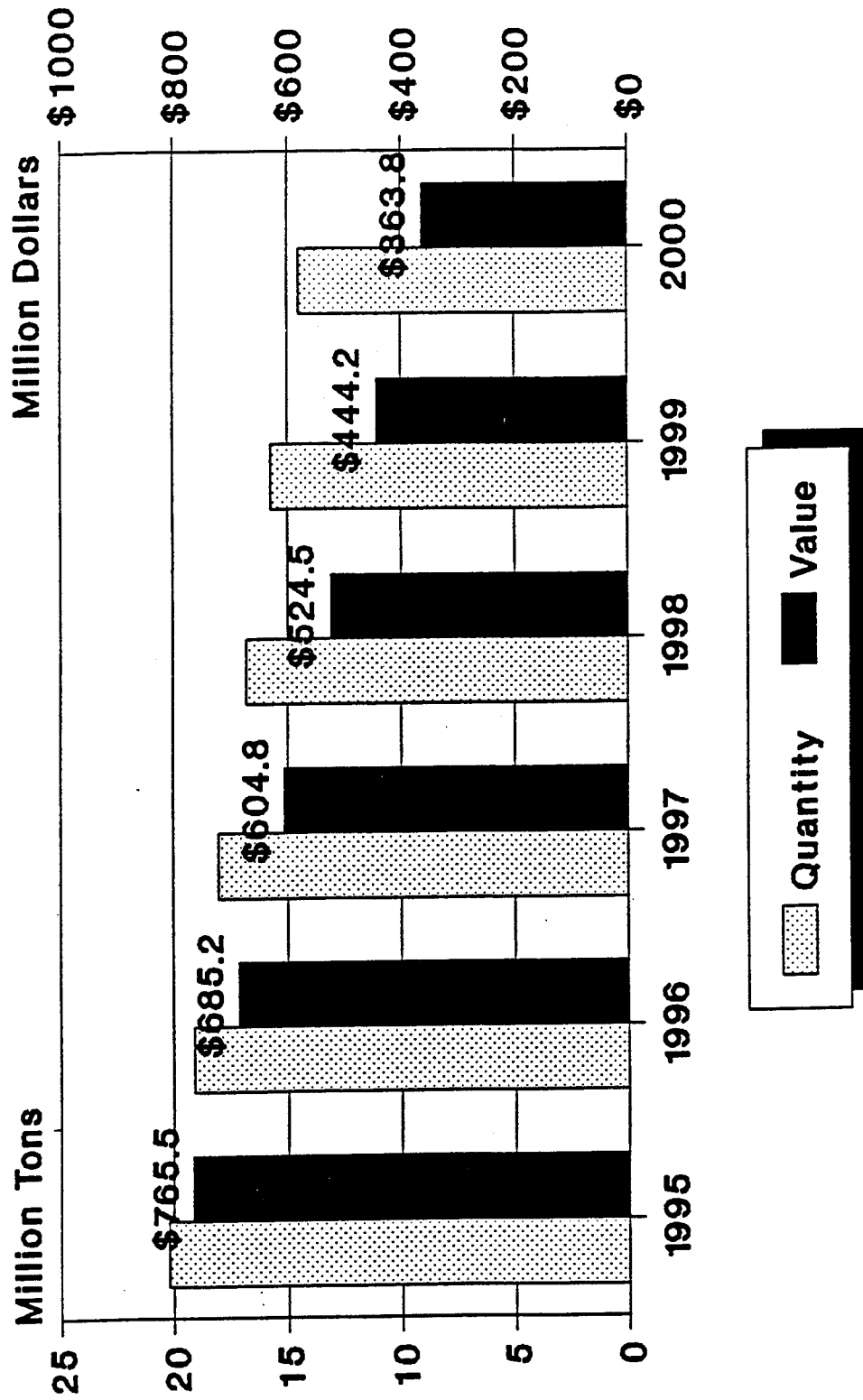
Although the GATT will have modest impacts over the long-term, it will not likely be a major issue in the 1995 farm bill debate. For U.S. feedgrain producers, the GATT offers modest export gains and inflicts little pain associated with reductions in government support. For protected commodities, it offers some degree of escape from much of its discipline. Environmental impacts on agriculture appear to be generally positive, so long as the GATT leads to greater decoupling.

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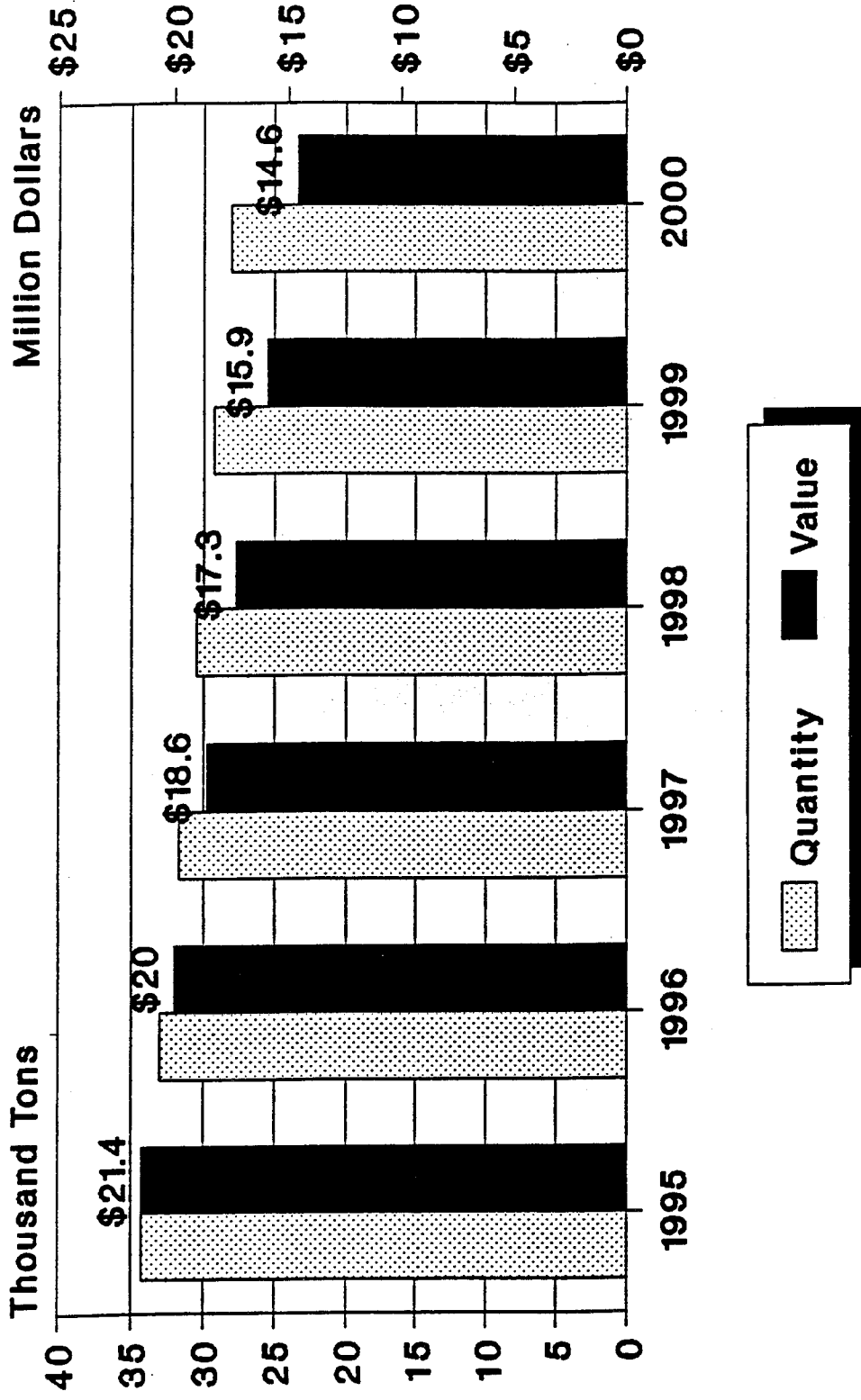
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Figure 1. Maximum US Export Subsidies Allowed on Wheat Under Uruguay Round



USDA, FAS Fact Sheet

Figure 2. Maximum US Export Subsidies Allowed on Poultry Under Uruguay Round



USDA, FAS Fact Sheet