Export Subsidies on Value-Added Products

Editor's Note:

In the 2nd Quarter 1988 issue a CHOICES Debate focused on the advisability of "subsidy value-added products." Paul B. Green, a consultant to the Miller's National Federation and other agricultural processors, argued that "our trade policy needs them." Ewen M. Wilson, Assistant Secretary for Economics, United States Department of Agriculture, argued that the effects of such policies may differ from policy objectives. Here the authors respond to the arguments presented in the previous issue.

by Ewen M. Wilson

It is true that exporting processed products rather than bulk commodities yields higher employment, income, and tax revenues for the domestic economy. However, export subsidies distort the economy and subsidizing exports of processed products from an industry that already is at full capacity breeds "new non-economically viable production." The European experience clearly illustrates this. There are serious questions about the effectiveness of export subsidies, the permanence of their effects, and the likelihood of realizing the full multiplier benefits from expanded exports.

Implicit in Paul Green's support of export subsidies is the belief that subsidies "buy" new markets and hold them long enough for the subsidizing nation to gain the full benefits from the higher levels of output. Yet the export subsidy program he wants to use, the Export Enhancement Program (EEP), was designed to be a short term, targeted trade policy tool. We are unlikely to see EEP produce the market development effect necessary for long term benefits. Without long term market expansion, the economic multiplier effects are much smaller than those Green uses.

The Economic Research Service study from which Green obtained his multipliers cautions about the special conditions which must be met to realize the full multiplier benefits. First, there must be sufficient unused domestic capacity so that all increases in demand are translated into increased levels of economic activity. Otherwise, the additional processing activity would lead to bottlenecks that would bid up prices of supporting goods and services, resulting in price inflation or curtailed levels of activity in some other part of the economy. Second, the multipliers used in the illustration apply only to new production for markets that are not already in surplus. The implied effects would not be fully realized if subsidized exports simply substituted for unsubsidized exports.

Still, the essential issue is not whether we would be better off subsidizing wheat or wheat flour, but whether we would be better off both in the United States and globally if we could achieve significant multilateral trade liberalization. We should focus on the fundamental issue of liberalizing world trade.

by Paul B. Green

Two further points on the discussion of value-added products and trade policy:

- One of the most prevalent topics heard in Washington, DC agriculture circles the last few years is "rural development," yet no one seems to know how to stimulate economic vitality in rural communities without a constant infusion of federal monies.

I submit that our approach to rural development should be based on the premise that some economic value be added to agricultural products before they are transported away from the rural areas where they are produced. The private sector would have an incentive to invest and create such activity if they were given access to the huge high value and value-added market discussed in the last issue of *CHOICES*. Therefore, challenging predatory trade practices in processed product markets could be the single most effective rural development policy.

The U.S. currently holds about a 10 percent market share of high value/processed products trade. USDA-ERS notes that we could increase our market share to 15 percent *without sacrificing leadership in bulk commodity exports.* They conclude that a market share of 15 percent would add $50 billion to the GNP and generate an additional one million jobs. That additional $50 billion GNP would result in a minimum of $2 billion in additional federal tax revenues, not to mention additional revenues at the state and local level.

- The occurrence of a serious drought in U.S. spring wheat, corn, and barley crops this year has created a further quandary for administrators of the Export Enhancement Program. Media coverage has left the public with the perception that the U.S. is subsidizing exports at a time of imminent higher domestic food prices.

The EC, meanwhile, is coming off a good grain harvest and is indicating its intention to take advantage of the U.S. drought to recapture all the market share the U.S. took the last two years through the use of EEP. If the U.S. does not show resolve to challenge export subsidies in a targeted manner during this difficult year, we will return to complete domination of agricultural trade by the EC and a huge opportunity for U.S. farmers and rural America will be lost.