U.S. AGRICULTURAL POLICY AND WORLD TRADE

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The U.S. agricultural economy has become a trade driven system. Exports have become crucial in determining commodity prices for those commodities which use a high proportion of our cropland, and these commodity prices in turn are a major determinant of livestock and poultry output and prices. All of this is well understood by agricultural economists, by most farmers, and by most policy makers. Our current domestic farm policy accepted this fact and then made certain assumptions about the export market and its future behavior.

Those assumptions led us to construct a certain kind of domestic farm policy, which worked reasonably well over the decade of the 1970s. There is a serious question, however, as to whether the assumptions are valid for the 1980s and beyond. I want to examine this question and then to discuss briefly what we can do if our assumptions were wrong.

The basic and most important assumption was that world demand for imports of U.S. farm products would expand rapidly enough to absorb the growth in U.S. production and that of other competing exporters at prices which would provide reasonable returns to the owners of resources employed in the system. In economists' jargon we would have "market equilibrium", and there would be no need for the controversial and expensive domestic farm programs which had been the norm in U.S. policy for the entire period since World War II. Of course, it was recognized that there would be fluctuations in export demand from year to year, primarily because of weather.

In order to undergird the system, a rather simple system of price supports, target prices, and a farmer-owned reserve was established. The price supports were to be set at market-clearing levels, thus avoiding government stock accumulations and undue enhancement of world market prices. The target prices were to be set to cover the variable costs of production and to thus protect farmers' incomes in those rare years in which the market demand was not adequate. The reserve was to accumulate stocks in those years in which either our own supplies were unusually large or foreign import demand fell off because of unusually good weather. Stocks were to move out of the reserve in years

when our own crop was short or foreign demand was unusually strong because of bad weather.

This is the system that was put into place in the 1973 and 1977 Agricultural Acts and continued in the 1981 version. The underlying assumptions about export demand led directly to assumptions about how these programs would work. First, it was assumed that the price support and target price payments would rarely come into play, and therefore, government intervention would be rare and program costs relatively low. Second, it was assumed that the reserve would stock and destock on a regular basis and, thus, that reserve size would not continue to grow and add another major item to program costs. And third, it was assumed that our price support level would not become a significant factor in world market prices nor become a factor in our ability to export.

These assumptions were not confined to a few economists within the USDA or elsewhere. They were shared, not only by those who made agricultural policy, but also by those who made agricultural — and agriculturally-related — investments. This includes those who invest in port elevators, hopper cars, and barges, those who manufacture farm machinery, and those who make fertilizer, herbicides, and pesticides. Hundreds of billions of dollars were invested by the private sector in the United States and elsewhere around the world using the same assumptions. Many of the same assumptions were implicit in the Common Agricultural Policy of the European Common Market.

These assumptions seemed to hold for the decade of the 1970s. Farm exports grew every year at a healthy pace, farmers had the best real and nominal income in their lifetime, and agribusiness prospered. Farm program costs fell and government intervention in the market for agricultural products was sharply reduced. Then, suddenly in 1981, things started to go wrong! Export sales began to falter, then to decline. Stocks of farm products began to accumulate in government programs and in the reserve. Target price payments became necessary and large. Expenditures for farm programs began to mount to the point that they have become a significant item in a worrisome budget deficit and a significant fraction of net income from farming.

In a desperation move the administration developed the Payment-in-Kind (PIK) program which will be the costliest farm program ever run and which promises to give farm programs a bad name for decades to come. Meanwhile, exports are down sharply again in 1982/83 and are projected to fall even further in 1983/84. Public attention is being drawn to farm programs, and many are already saying that our program direction will have to change when the farm bill is considered in 1985.

All indications are that something is drastically wrong in our assumptions about foreign markets and foreign trade. At present we are

seeing a rise in commodity prices as a result of a drought on top of the most extensive and expensive land retirement program in history. This temporary improvement in commodity prices may lead some people to believe things are all right, but I do not think that is the case, and by this time next year I think it will be obvious to all once again. Let us look, then, at our international markets to see how our assumptions appear for the years ahead.

The Market Growth Problem

Our assumptions have been that foreign markets for agricultural products would grow at a healthy rate for the foreseeable future. This has been the case for a number of years and everyone assumed that it would continue. For instance, world wheat use increased in 18 of the last 22 years until 1981/82, when it fell for the first time since 1973/74, which was a period of world shortage and high prices. World coarse grain consumption increased in 17 of the past 22 years (with declines only in 1963/64 and in 1974/75 when poor Soviet and/or U.S. crops cut use) until we hit the three consecutive years starting with 1979/80 in which use declined.

As a result of this growth in use, world trade in wheat expanded in 12 of the last 15 years and trade in coarse grain expanded in 16 of the last 22 years. World coarse grain trade increased in every year but one from 1968/69 to 1981/82. It has now declined for two years in a row and the modest recovery now projected for next year would leave it at about the 1977/78 level. A similar story can be found for each of the major agricultural commodities moving in world trade.

During the period of rapid growth in world trade in farm products, two groups of countries accounted for all of the growth in imports. These were the middle-income developing countries and the centrally-planned economies of the USSR, China, and Eastern Europe. Japanese imports grew slowly, and Western European imports actually declined as local output expanded more rapidly than market demand. During the final years of the decade the import demand of the newly rich OPEC countries grew especially rapidly. As late as the fall of 1980 a careful analysis by the USDA suggested that demand for U.S. exports would continue to grow at healthy rates for at least another decade.

Underlying this growth in import demand was the very good economic growth that the centrally-planned economies and the middle-income developing countries had enjoyed during the 1960s and on into the 1970s. Of course, many of the developing countries had suffered severe balance of payments problems as a result of the "oil shocks" of 1973 and 1979, but these were easily financed by the highly profitable recycling of the OPEC surpluses by the world's commercial banks. Thus, the debts accumulated as a result of foreign loans in plant, equipment, and infrastructure as a part of the normal development

process were increased to finance the imports of oil, food, and other items of current consumption. Suddenly, in 1980 the realities of the situation began to catch up with the world, and we have found ourselves facing the most serious debt crisis since the 1930s.

The initial culprit was the worldwide economic downturn led by the U.S. and Western Europe as a result of the corrective monetary policies applied to stop the spiraling inflation set off by the second oil price increase. Two things happened at once.

One was that the market for commodities and manufactured goods, which the developing countries depend upon to earn foreign exchange, turned soft. Second, U.S. and world interest rates rose to record highs in both nominal and real terms, and since much of the world's debt is tied to floating rates, higher interest rate payments were added to a deteriorating balance of payments. Poland was the first country to announce that it could not pay its debts or even the interest on its debts in 1980.

Since then the number of countries joining the list is so long that it is easier to list those which are solvent than those which are not. The problem list now includes virtually every country in Latin America, all of Eastern Europe except the Soviet Union, and key importing countries in Asia and Africa.

The damper on foreign market growth that results from an economic slowdown creates a serious problem, but that problem is made much worse by the debt situation and the balance of payments squeeze. Recessions come and go, and this one has hit most of the countries worse than anytime since the 1930s, but the major question is will a worldwide recovery lead to the resumption of growth rates like those of the good years?

Many informed people think that unless extraordinary action is taken to deal with the debt problem, future growth will be slower. Future growth depends in part on additional long-term loans to finance productive investment.

Now, and for the foreseeable future, it is likely to be hard to find a commercial banker who wants to make loans to either public or private entities in those problem countries. And as our Congress is indicating, there is no great enthusiasm to rush in with large amounts of public loans. Thus, the odds appear very high that our underlying optimistic assumptions about foreign economic growth rates will not be realized.

The Trade Problem

Another problem has arisen which was not anticipated in our assumptions regarding the growth in agricultural exports. Over the last three years the U.S. has become the residual supplier in the world markets for our key agricultural exports. We have been losing market

share in a static or declining market which has been shrunk by recession, debt, and balance of payments problems. There are several reasons for this, and the impact has been different in different markets.

A major reason for our loss of market position has been the strength of the dollar against other major currencies. After a long and steady decline in the value of the dollar from 1973 to mid-1980, the dollar started to strengthen and has continued to do so through 1983. This has the effect of making our products more expensive to foreign buyers, and it makes it possible for our competitors to undersell us without cutting prices to their own producers in their own currencies.

The effects of the stronger dollar can clearly be seen by comparing the situation in August 1980 and in the second week of August 1983. In those two periods the farm price of wheat in the U.S. was $3.34 and $3.33 per bushel, respectively. However, because of exchange rate changes the price in German marks was DM 5.97 and DM 9.11. In French francs the 1980 price was FF 13.9, and the 1983 price was FF 27.4. In Japanese yen the comparable figures are y 749.6 and y 821.5. Thus, even though our producers were getting the same price in the two years our foreign buyers were paying substantially more. It is not surprising that they are buying elsewhere when they can and holding their purchases to a minimum.

The other effect of the strong dollar is the protection and encouragement it gives to our competitors. Let us look at these same figures in that context. In August 1980 our wheat price translated into $2.89 Australian, in August 1983 our wheat price translated into $3.82 Australian. In other words the change in the exchange rates will allow the Australian farmer to receive almost $1 a bushel more for his wheat while our producers get the same. Or conversely, Australian wheat can undersell ours in the world market by a little bit and still have it return more than it did three years ago. It is not surprising to learn that Australia is likely to produce and export the largest quantity of wheat ever!

There are several reasons for the strength of the dollar. One is that capital is flowing from other countries to the U.S. because it appears safer here. This is a common occurrence during times of financial and political instability. However, the major reason for the strength of the dollar is the large capital flows brought on by the immense federal deficit. The large federal deficit requires that the federal government borrow large quantities of money in the money markets. In order to attract sufficient funds from at home and abroad the government has to pay high interest rates and these high rates encourage large capital inflows which cause a strong dollar.

Another reason for the capital flows is the foreign investments that foreign firms are making in the U.S. to avoid the ever-increasing threat of U.S. import barriers. Ironically, much of the pressure for import barriers comes from the crippling effect that the strong dollar has on

both our import and export position. In general, however, there is no escaping the fact that most of the strength of the dollar is the result of our own unfortunate fiscal policy.

It would be foolhardy to predict that the dollar will continue at this level relative to other currencies for the indefinite future. However, at this point there is no evidence of the political will necessary to get our fiscal house in order and, thus, this drag on our exports may continue for some time.

Another reason for our weakened competitive position is our image as an unreliable supplier. Each of the last four presidents has restricted exports, either for short supply or foreign policy reasons. The most famous and well remembered of these is the Russian grain embargo of 1980 which was imposed by President Carter in response to the Russian invasion of Afghanistan. Each President has promised that they would not do something like that and each time the Congress has added penalties for doing it, but foreign buyers are somewhat skeptical of these disavowals and probably rightfully so. As a result foreign buyers diversify their sources of supply of farm products and reduce our market share.

Another factor which adversely affects our export position is our foreign policy. By and large we do not let our foreign policy position stop us from exporting to a country, because our exports are done by the private trade, and they will sell to any country unless such sales are specifically forbidden by law or executive order. This separation of foreign policy and trade is not so sharp on the importing side, however. In most countries importing is either done directly by the government or is closely controlled by the government. Thus, while we may say that we will sell grain to the Russians even though we don't like them, the Russians tend to reward their friends by buying from them while ignoring those they aren't getting along with.

This attitude has certainly been a factor in their limited purchases of the last two years and is likely to continue to be a factor as long as tensions between our countries are high. The Chinese announced last spring that they were limiting their purchases from us, because they didn't like our textile import policy. Other countries do the same thing, but they usually are less obvious about it and the impact is less visible. This sitution is likely to continue for the indefinite future. A great power like the United States cannot let its foreign policy be determined by any narrow economic interests, and, thus, we can expect to have some of our export interests come into conflict with our foreign policy from time to time.

Changes in Competition

All of these factors — the strong dollar, the unreliable supplier label, and foreign policy — would be much less of a problem if the nature of our competition had not changed over the last five years. When the

export boom began in the early 1970s the U.S. could expand output rapidly by merely returning to use land which had been idled by farm programs. Moreover, the great flexibility which marks our agricultural system made it possible for us to respond quickly. As a result the U.S. got the lion's share of the expanded export market through most of the 1970s.

In the late 1970s however, both area harvested and yield for wheat and coarse grains in Canada expanded. As a result, Canadian wheat exports rose by 50 percent from 1972/73 to 1982/83, and barley exports rose even faster. In Australia both acreage and yield also rose, and Australian exports rose at the same time. In Argentina land area didn't change so much, but yields rose very sharply and exports rose accordingly. Those three major competitors doubled their exports of wheat from 1973/74 to 1983/84!

Matters have been made worse by the change in the Common Market's position from a large net importer of grain at the beginning of the 1970s to a significant net exporter of grain beginning in 1980/81. This is especially important for wheat where the EC is now the third largest net exporter following the U.S. and Canada. This situation was the result of sharp rises in yields in Europe, not as a result of expanding land area.

Much, probably too much, has been made of the effect that the European Agricultural Policy has had on expanding grain output in the Community. And there is no question that they could not export with their high internal price level without export subsidies. But, even if all that is true, the fact is that the EC is now a surplus grain producer and is likely to continue to be under any policy that appears to be politically achievable in the foreseeable future. Unfortunately, their surplus production also extends to meat, chickens, and a host of other products — and our increased competition is not limited to these few countries. Brazil has expanded output of soybeans and chickens, Thailand of rice and corn, and the list is growing longer each year.

Both the U.S. and a number of countries have responded to the rise in agricultural commodity prices which occurred in the last decade. As it happened, the U.S. reponse was quickest, but now we face competition for export markets far beyond what we imagined or projected when we were making our estimates of export potential which undergird our farm policy. Now this competitive export capacity exists and may be almost impossible to drive out of business.

Where Do We Go From Here?

For a series of reasons which I have tried to outline it appears that the basic assumptions about exports which formed the basis for our domestic farm programs clearly are wrong now and may remain that way for some years to come. There is a natural tendency in our political system to avoid change, especially those changes which cause eco-

nomic pain and political losses. Avoiding doing something may not be possible in this case, however, because to do that results in a worse situation and more pain and losses. It is important, therefore, to start thinking now about what alternatives are available and what they would mean.

The first inclination is to say that if something is wrong in the international markets we should fix things there. Unfortunately, that will be easier said than done. The problems I have outlined in that area are only partly under our control at best. We can take action which will help economic recovery abroad and assist in the debt and balance of payments problems, but such actions will not be very popular politically and their success will be dependent upon other countries' actions as well as ours. Certainly, if such actions are taken, they will not be taken in the name of farm exports, but in the general national interest.

If fixing the international markets turns out to be beyond our economic and political ability, then we will be forced to look carefully at our domestic policy options, and large and powerful groups are not going to like what they see.

One option is to return to a more or less permanent program of production adjustment which shrinks our agricultural plant until world market growth resumes and will absorb our products at satisfactory prices. This might appeal to many farmers, but they are not the only ones who will be heard on these matters. We now have a huge agribusiness economy built around fully using our productive capacity and large exports. Those interests would be hurt badly by a return to the old programs, and they will resist mightily. Moreover, that approach to the problem will help entrench our competitors' position in world markets.

A second approach is for us to lower the safety net of price supports enough to expand sales and to encourage reduced output both here and abroad. This is the direction which the current administration has proposed, but it is not at all clear that the Congress will accept it at this time. The one thing that is sure about this approach is that it will cause some pain and deflate the value of some agricultural assets along the way.

The only thing that is absolutely certain is that the process of adjusting to a different world than the one we assumed will be filled with political controversy of the type we have not seen since the 1960s. Even though it has not always seemed so, the domestic farm policy scene has had relatively little controversy for the last decade and a half. For the next several years those involved in farm policy will also find themselves involved in issues which will divide commodity groups, regions, and political parties.

As the old Chinese curse says, "May you live in interesting times."

WORKSHOPS

FARM COSTS AND EXPORTS

REGIONAL CONFLICTS IN AGRICULTURAL POLICY

IMMIGRATION AND AGRICULTURAL LABOR POLICY

PROTECTIONISM

THE IMPACT OF INTERNATIONAL TRADE POLICY ON CONSUMERS

REGIONAL RESOURCE CONFLICTS