TRADE WAR OR NEGOTIATIONS: WHERE ARE WE HEADING?

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The state of the U.S. agricultural economy has become a major concern to both the Administration and Congress. With the U.S. losing market share in a declining export market and with protectionist pressures increasing around the world, it becomes more and more difficult for the U.S. to maintain its free trade stance.

Unfortunately, attempts by the U.S. to convince our trading partners to share in the international market responsibility have not been satisfactory. Several initiatives to improve both the domestic and the U.S. export market situation have been undertaken.

First, in response to international debt and declining purchasing power the authority to provide credit guarantees for agricultural commodity exports under the GSM-102 program was increased from $2.8 billion to $4.8 billion and is likely to increase further.

Second, to meet the competition in a variety of markets the blended credit program was developed and to demonstrate our seriousness in objecting to EC export subsidy practices the U.S. used a direct agricultural export subsidy for a selected targeted market — wheat flour to Egypt. While the preference for free and open markets for agricultural products as well as for non-agricultural products remains, the alternatives to EC subsidies was to accept not only depressed export sales due to a declining international market, but also a declining share of that smaller market if we continued alone to curtail production and resist protectionism. Recently a sale of 18 thousand metric tons of butter and 10 thousand tons of cheese to Egypt was announced. Other actions of a similar nature have been proposed. We hope they will not be necessary, but we are keeping our options open. On the domestic side, the U.S. has had an acreage reduction program and an acreage diversion program to reduce production. In addition, a payment-in-kind program to reduce the surplus stocks overhanging the

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market and to reduce government stockholding costs was implemented.

The U.S. Congress is in a mood to do more, particularly with respect to the export market. While Congress has passed no legislation affecting agricultural exports to date, many proposals are being considered. It is difficult at the moment to predict what will result from the interplay of forces presently acting in the U.S. Congress.

On the one hand are those calling for strong measures to protect the domestic market, and to do whatever is necessary to become once again competitive in the international market and regain market shares lost to subsidized and unfair competitive practices. On the other hand are those who want the U.S. to remain true to the free trade philosophy and to continue to adhere strictly to the principles of trade based on comparative advantage. Each side is asking the other, "At what cost do we follow your alternative?"

The European Community has tried from time to time to find ways to restrict oilseeds or increase the consumption of grains. They are trying again now with a proposal to subsidize the use of Community-grown grains and oilseeds and a proposal to put a tax on sales of vegetable oil.

In general, the trading rules of the General Agreement on Trade and Tarriffs (GATT) prohibit the use of nontariff measures to restrict trade. However, there are many exceptions including some of those just mentioned. Restrictions are permitted to protect human, plant, and animal health. Subsidies are recognized as necessary for a number of purposes, although subsidies on exports of agricultural products are to be avoided whenever possible. (There is no outright prohibition on subsidies of unprocessed products.) Restrictions on imports are permitted to support domestic farm programs, if those programs in turn are to restrict domestic production.

Many countries do not live up to these rules. When the U.S. could not meet them, other GATT members gave us a waiver from our GATT obligations. Other countries, however, simply act illegally. The U.S. is now challenging a number of import quotas that Japan has maintained for years. The Europeans protect their most important products with variable import levies, a type of measure which was not known in 1948 and which the Community claims is therefore not covered by the GATT rules.

The last round of trade negotiations, the Tokyo Round which ended in 1979, was conceived at the beginning of 1972 when the European Community and Japan agreed to such negotiations as part of an agreement in which the U.S. devalued the dollar. In the Tokyo Round, for the first time in many years, a major attempt was made to bring GATT rules up to date and expand them in many areas, including subsidies, product standards, government procurement, customs valuation, and others.

The two most important areas of agriculture were the agreements or codes on subsidies and standards. The Standards Code has been very helpful in requiring countries to announce in advance when they plan to change import or internal standards and be willing to receive public comment on the changes.

However, the Standards Code has been much less successful in the area of dispute settlement because the Europeans and others have refused to allow the agreed dispute settlement procedure to be applied to the kind of health and sanitary issues involved in meat inspection. In their view, the code does not deal with the conditions under which a product is produced, but deals only with the specifications — grade, size, etc. — of the product itself.

The Subsidies Code also poses a major problem. GATT rules do not prohibit the use of export subsidies on primary agricultural products, but do say they should not be used when they result in the exporting country's obtaining more than an equitable share of world trade.

The negotiators of the Subsidies Code hoped that they could make this concept more precise so that some subsidies at least could be ruled out. The code does provide some definitions of equitable share, which are intended to prohibit a subsidizing country from displacing another country in a given market or from price undercutting.

The U.S. has now invested two years in testing the Subsidies Code with specific cases. The results have convinced us that new rules are necessary. The basic situation remains the same as it was before the Tokyo Round, namely, the rules aim at limiting damage from subsidies rather than limiting subsidies themselves. Even with the stronger rules under the Subsidies Code, damage is not easily proved.

Further, the GATT is not a tribunal. It is instead a group of countries all of whom have an interest in the subsidy question. As a result, the procedures have taken much longer than foreseen and the findings are not clear-cut.

Most of our test cases have involved the European Community. We have been engaged throughout this process in intensive discussions with the European Community to try to reach a new understanding with which we can both agree. Since the Community is the world's largest user of direct agricultural export subsidies, the Community's only interest in restricting use of subsidies would be if subsidy actions by the U.S. and others are sufficiently costly to the Community to make an agreement desirable. When the U.S. takes such actions there is a natural concern that we may be headed for a trade war.

A trade war is never our objective. Negotiation is the usual way of avoiding one. The real U.S. objective is to negotiate a workable subsidy code, one that would defend the agricultural trade interests of all countries and, in the process, assure that U.S. exporters can compete in markets when they are confronted by the unfair trade practices of others.

U.S.-EC Bilateral Talks

This principle of negotiation was behind the recently completed six months of U.S.-EC high level consultations, which commenced after the GATT Ministerial of November 1982. Unfortunately, after all the talk ended, we were unable to point to any substantial results. While the discussions were constructive, there was little progress in moving toward greater discipline regarding export subsidy practices.

Even the small positive results that came from the talks were temporary. For example, the EC commitment to limit soft wheat and flour exports to the previous year's level was only for the 1982/83 marketing year.

Less substantive but of longer term was an agreement on a formal bilateral information exchange program on agricultural trade and market developments. This was so both sides would have more detailed and timely information on factors which could lead to potential trade conflicts.

Vulnerability of Agricultural Trade

In assessing the alternatives being proposed it is important to recognize that international agricultural trade has been and continues to be particularly vulnerable to the protectionist actions of nations. Agricultural trade is particularly vulnerable to protectionist actions for three primary reasons.

(1) All nations desire to be as self-sufficient in food as their resources will permit. Most governments want to nurture their food production systems and support their farmers to encourage production.

(2) Agricultural production cannot adjust quickly to fluctuations in demand. Its production cycles are measured in months and years, not days or weeks. To protect farmers, all governments drift into protectionist actions.

(3) Largely because of the first two factors, the world community has never faced up to the difficult task of establishing workable rules for agricultural trade.

No round of multilateral trade negotiations, since GATT was established, has treated agricultural trade as much more than an afterthought.

While steps were being taken in the Dillon, Kennedy, and Tokyo rounds to reduce tariffs and control subsidies in manufactured goods, groups were formed to "study and recommend" solutions to agricultural issues. Despite the benefits to be had from freer trade, agricultural trade issues remain "under study" today.

We are paying a heavy price for those years of neglect — in destablized trade, in rising discord in trade relationships, in low farm prices, and rising government costs.

Fingers are being pointed in all directions, accusations are made, and petitions filed with the GATT as to who is doing what to whom in agricultural trade. No country is immune, but the most attention and the sharpest rhetoric has been generated by the trade differences between the U.S. and the European Community.

This is not surprising. Together, we account for about half of all agricultural trade; we are good customers for each other, and at the same time we are strong competitors. Fortunately, we have toned down the rhetoric. But the issues remain. The U.S. and the Community arrived at this point by taking different routes to the same objective — that of a stable income for our farmers with a fair return for their capital and labor. The Community, in 1957, chose a system of high, protected support prices to encourage production toward what seemed a far-off dream of food self-sufficiency, with a system of export subsidies to move surplus production onto the world market.

The U.S., after years of rigid controls and troublesome surpluses, moved toward a market-oriented farm policy in the 1960s and completed the transition for most commodities in 1973.

Both systems worked well. Strong global economic growth during the 1970s and severe production shortfalls among major importers combined to generate unprecedented growth in import demand and export opportunities. The U.S. and the Community shared in this growth. The growth helped the U.S. ease out of its costly farm programs and the Community to dispose of the surpluses generated by high price supports. U.S. farm exports grew 21 percent per year in value and those of the Community to third countries rose at an even faster rate.

In turn, both the Community and the U.S. have become heavily dependent on exports. We must export 25 percent of our farm production just to maintain farm prices at the levels set by the Agriculture and Food Act of 1981. The Community must export 20 percent of its farm products to dispose of the surplus generated by its rising support prices.

Since 1980, world agricultural trade has changed dramatically. World agricultural trade growth in the 1980s has averaged less than 1.5 percent per year in volume terms compared with a growth of four to five percent in the 1970s. Trade in grain has actually declined. Record or near record world crops combined with the decline in trade produced huge supplies and a drastic drop in farm commodity prices.

The responses of the U.S. and the European Community to the slump in world demand have been dramatically different. With world trade stagnating, the Community increased its production, setting two farm output records thus far in the 1980s. It also stepped up its subsidy program. EC exports to markets outside the Community have set records for three years in a row. EC stocks are relatively unchanged, and producer prices have been unaffected by world events.

In contrast, U.S. agricultural exports dropped last fiscal year for the first time in 13 years, and they will be down again this year. Stocks are up and would rise again but for government-financed acreage reductions and drought.

The results of those differing responses have been the same in one respect — a sharp increase in government costs. In the U.S., farm support costs have tripled in two years. In the Community, agricultural expenditures are at or near the limit of spending authority, pushed by export subsidies expected to total nine billion European Currency Units this year, 50 percent over 1982.

So here we are, the world's leading agricultural traders, both draining our treasuries — one to increase exports, the other to offset export decline. And we can't seem to agree on what to do about it. The U.S. believes that the market, not governments, should bear the cost of trade. We believe that market forces, not government, should be the primary influence on the movement of trade.

We believe a system of disciplined agricultural trade, based on the principle of comparative advantage, offers the best use of agricultural resources for the benefit of producers and consumers alike — a system in which government's main role is to assure the production adjustments necessary for balance in global supply and demand.

The events of the recent past show more clearly than ever that this approach cannot be unilateral. And they also show that, in an interdependent trading world, dichotomous policies among traders can be painfully expensive — almost $15 billion estimated for farm supports in the Community this year, not counting individual member state supports, and about $21 billion in the U.S.

Our concern in the U.S. is not the $15 billion that the Community will spend for its farmers — it is Community money. Our concern is with the share of that money that goes to pay for export subsidies — we are paying part of that cost. We cannot lay all of our export decline at the door of the European Community. The appreciation of the dollar, slack demand, and other factors bear on the decline. But Community export subsidies have hurt U.S. farmers and those in other countries as well.

U.S. Department of Agriculture analysts calculate that Community trade programs now displace $9 billion a year in world trade in products of interest to the U.S. — 14 million tons of grains and grain products and two to three million tons of livestock products.

The U.S. share of this displaced trade represents a loss in exports of $6 billion a year, and that translates into a loss to U.S. farmers of $2 to $3 billion in net farm income and an increase of $1 to $2 billion in U.S. government payments. If production and trade conditions are unchanged over the next three to four years, our analysis shows that U.S. export losses to Community subsidies are likely to reach $8 billion a year by 1987. In this situation, the temptation in Washington to meet this kind of competition by taking measures of our own might be contrary to our policy of liberal trade.

The U.S. is spending billions this year to take grain land out of production, while Community acreage is little changed, with the surplus from the harvest destined largely for subsidized export.

The U.S. this year will spend $74.8 million on storage to keep surplus dairy products off the world market. The Community has appropriated $1.9 billion to subsidize the export of surplus butter, cheese, and nonfat dry milk into export.

The U.S. has not raised its dairy support prices since 1980 and is working in the Congress to get them reduced. In the same period, dairy price supports in the Community have been increased by 23 percent. The strong trade position of the Community today — first in exports of sugar, dairy, and poultry, second in beef and veal, third in wheat — is far different from its position 25 years ago. And all are based on a strategy of high internal support prices and large export subsidies.

EC trade policies today have a worldwide impact, and they produce a worldwide reaction. Brazil, Argentina, and Canada are trying to stay price competitive with measures of their own — export subsidies, prices controlled at below market levels, and other measures. As we might expect, we are seeing a growing and alarming dependence on government treasuries to determine the flow of trade. There must be a better way.

Those of us who looked forward to the GATT Ministerial as the time to face up to the inadequacies of the Subsidies Code and other rules for agricultural trade are disappointed. And even though it is not only the EC with which we differ, the U.S. and the EC have a special responsibility to point the way to long-term, stable, sustainable growth in agricultural trade.

The Push for Fairer Trade

Why do we push so hard for freer, fairer trade? It certainly would be easier, in light of the efforts we expend trying to make our trading partners more responsible, if we just did as most of our trading partners do. So why do we persist? The reasons are partly a matter of principle, but mostly pragmatic economics.

U.S. trade policies are based on the belief that liberal trade offers the way for the most efficient use of agricultural resources in a world of rising populations and increasing interdependence.

Each nation, according to the theory of comparative advantage, should produce for the world market those products it does so best and most efficiently. Producing food and fiber products is a job that should be done most efficiently. It is in the interest of all nations to use the earth's resources — which are finite — as efficiently as possible to provide for the basic needs of all peoples.

Trade barriers work against the efficient production and distribution of agricultural products. We are concerned by measures increasingly taken by some countries to insulate and stabilize their food supplies at the expense of the orderly movement of trade.

Where our government is not successful in freeing up trade, or removing obstacles, or reducing foreign export subsidies, we do not plan to sit idly by. And there are signs of change, indications that this message is beginning to get through.

In the final analysis, the problem and its solution is much broader than just agriculture. World economic recovery and the strengthening of international agricultural markets that would result would go a long way toward making the present problems and issues disappear. In the meantime, everything possible must be done to keep the international market open and free and to resist further protectionist actions, or we run the risk of repeating the mistakes of the 1930s. The U.S., however, cannot and will not travel the free trade path alone. It is time for us collectively to choose our agricultural trade destiny.

Trade policy today is an international activity. To be effective, it must be matched in each country with domestic programs that facilitate the international flow of commodities — rather than have governments themselves competing for those same commodities. The ability to export depends on matching internal policies to world markets. Placing this principle in effect in all countries would remove much of the conflict in trade relationships and in world markets.

We remain hopeful that trade issues can be resolved via negotiations. This is our objective in pressing for discussions on the subsidy code. Such discussions can remove some of the antagonisms that currently affect our bilateral relations. An agreement on a tighter subsidy code could set in motion a more favorable climate for years to come. This certainly seems worth the full effort of both the United States and the European Community.