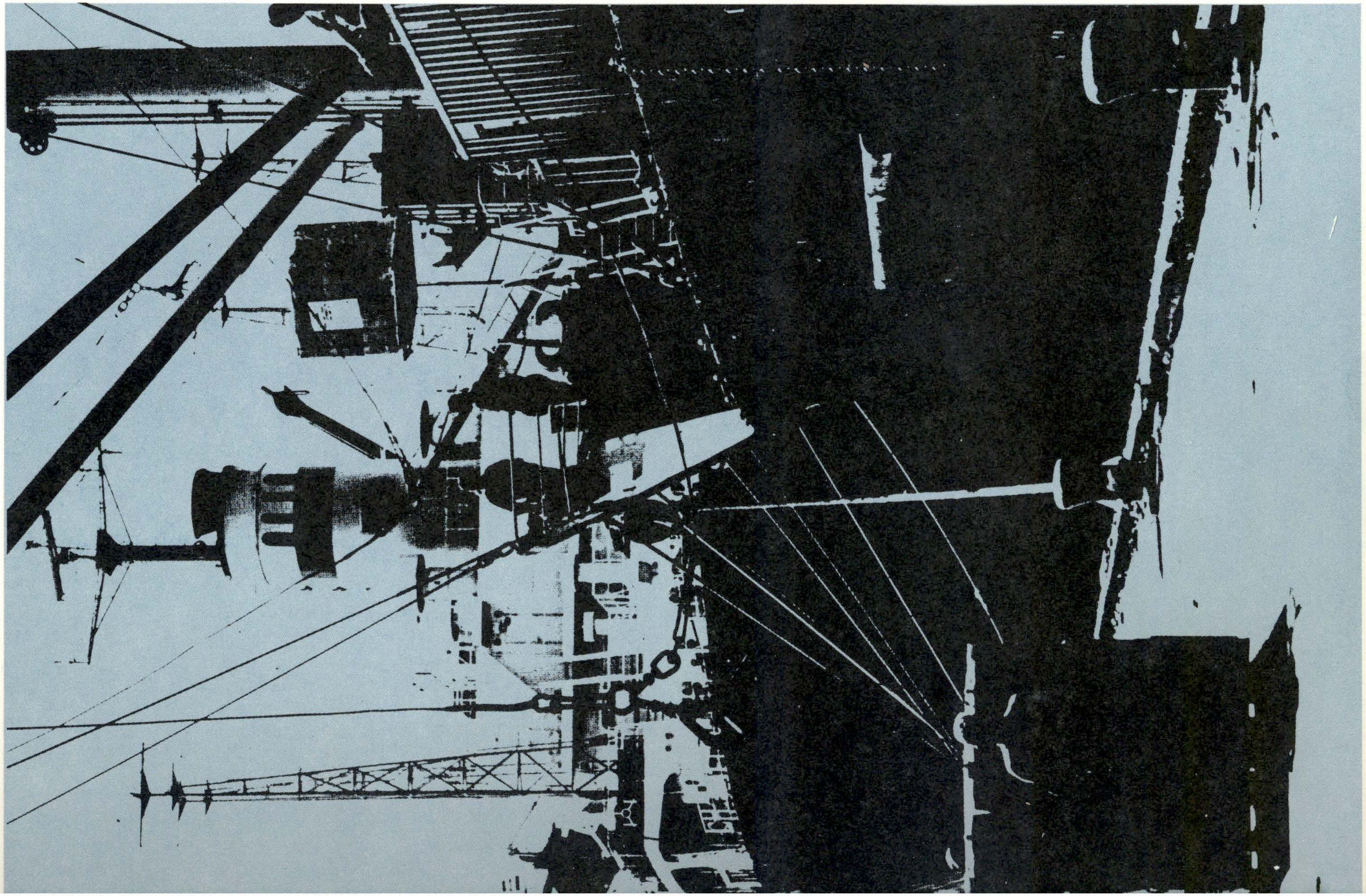
SPEAKING OF TRADE

Key Issues for Agriculture



Protection or Free Trade

James P. Houck and B.H. Robinson

"Free trade, they concede, is very well as a principle, but it is never quite time for its adoption."

Ralph Waldo Emerson

In the idealized world of international trade theory, nations always can capture general economic gains by eliminating tariffs, import quotas, export taxes, and other such trade impediments. These gains emerge from two sources: (1) specialization in production among nations and (2) access to more favorable world prices for both buyers and sellers. But these potential gains from free trade are not distributed smoothly among or within nations. In fact, some people, some industries, and some communities actually may suffer reduced incomes and economic opportunities because of increased trade. That, in a nutshell, is why the long-standing debate between "free trade" and "protectionism" goes on and on.

Completely free trade does not exist anywhere in today's world and probably never has. Some government intervention always is involved and will continue as long as nations with different political philosophies, economic and social objectives, and internal problems continue to exist. Even so, countries continue to trade with each other, some rather freely and some under very strict, central controls.

In this publication, we will look briefly at the essentials of this debate. We will focus particular attention on why nations erect trade barriers for protection against outside economic forces. Then we will consider the resulting gains and losses.

Let the term "free trade" refer to the international commerce that would occur naturally without direct government intervention in pricing or exchange, except for minimum regulations needed to facilitate buying and selling. On the other hand, "protection" occurs when, through economic policies, any group of producers or consumers is insulated deliberately from the full force of international competition.

Trade protectionism usually enables some group to protect or expand its market. Import restrictions and export subsidies most often are used to achieve this goal. Recently a new protectionism involving export controls on behalf of domestic consumers and users of export goods has emerged. Each of these devices is important for one or another U.S. agricultural product. For example, import restrictions exist in several forms for meat, dairy products, and sugar to help protect domestic producers and processors. Wheat export subsidies were used before 1973 to assist U.S. wheat producers in holding or expanding their overseas markets. Soybean export embargoes were employed in 1973 to protect domestic consumers and users from high prices generated by eager foreign buyers.

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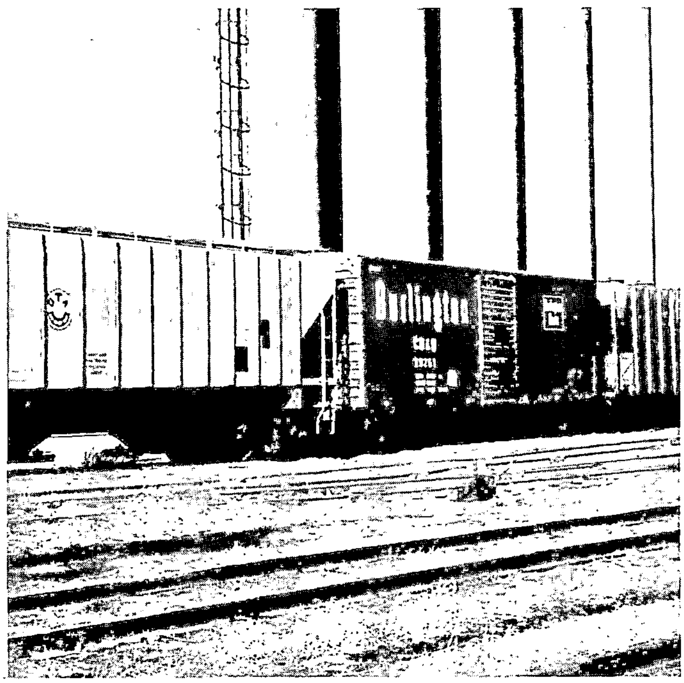
Despite these and other protectionist measures, the United States has encouraged freer trade among nations in various international negotiations. Our overall record, while mixed, is generally consistent with this free trade philosophy. Yet, as with all trading nations, protectionist pressures continually crop up. Today the pressures are coming frequently and insistently.



WHY IMPORT PROTECTIONISM OCCURS

The classic method of import protection is a tariff, sometimes called an import duty. It is either a fixed charge per imported unit or a fixed percentage of each shipment's value. Nontariff protection devices include import quotas (direct quantity controls), mixing regulations, complex packing and labeling requirements, health and sanitary regulations, foreign exchange restrictions, and minimum import prices sustained by variable import duties. All of these devices make it more difficult (sometimes impossible) for foreign sellers to compete with domestic sellers. All nations use at least some of these measures.

Historically, tariffs have been a major source of government revenue for many trading nations including the United States. The famous tea import tariffs had no protective value for anyone in the 13 original American colonies. They were simply a tax on colonial tea consumers, with the revenues going to the British government.

Tariffs can be attractive as a revenue source because of their ease of collection. This is especially true for some developing countries where income or profits taxes are difficult to collect. On the other hand, most developed countries levy tariffs mainly to protect domestic industries. United States tariff revenues in 1977 generated only about 1.4 percent of all government receipts.

Protect a New Industry?

Tariffs and quotas may be used to protect new industries. For example, suppose that nation A does not produce cotton, but buys it from nation B. Cost studies might show that if A tried to produce its own cotton, the cost would be higher than B's cotton price. However, the studies also might show that A's cost disadvantage is only a short-term problem. If A somehow could begin cotton production, it might in time be just as efficient as B. But time and money may be required to construct efficient irrigation facilities, train producers, and obtain specialized equipment. To enable A to get into cotton production, a tariff might be added to the price of cotton imports from B so that A's producers could begin to compete in the local market. Through the tariff, the consumers in nation A would pay a subsidy to their cotton producers hoping that someday the new industry would be efficient. This is called the "infant industry" argument.

If a young industry has the political power to obtain a protective tariff, it may have power to continue it. If this occurs, the infant may never grow up, and consumers may find themselves permanently protecting jobs and incomes in the favored but inefficient industry.

Protect National Security and Health?

With trade, specialization in production tends to occur among nations. This tendency might cause a particular domestic industry to shrink below the size considered prudent in case of emergency. In times of international upheaval or actual war, trade may shrink or stop entirely. If nation A were dependent upon nation B for the weapons of war, then A would be particularly vulnerable, especially if B were its enemy. Thus, many nations maintain industries to produce the essentials of war — food and weapons — even though the principles of free trade dictate otherwise. Maintaining industries that are not economically efficient keeps a nation's level of living from reaching its potential. However, if that nation might cease to exist by losing a war, then its citizens might be willing to lower their living standards to protect industries essential to national defense. These industries include agriculture, oil, steel, aircraft, and electronics.

The free trade of goods between nations may be restricted for health reasons. For instance, the United States prohibits the importation of fresh or frozen beef from countries that have a history of foot-and-mouth disease. Likewise, some nations restrict imports of U.S. frozen poultry, fearing infection of their flocks with Newcastle disease. In some countries, including the United States, some metropolitan areas do not permit fluid milk to be sold freely within their jurisdictions unless the dairy farms, domestic or foreign, have been approved by their own inspectors.

Offset "Unfair" Foreign Trade Policy?

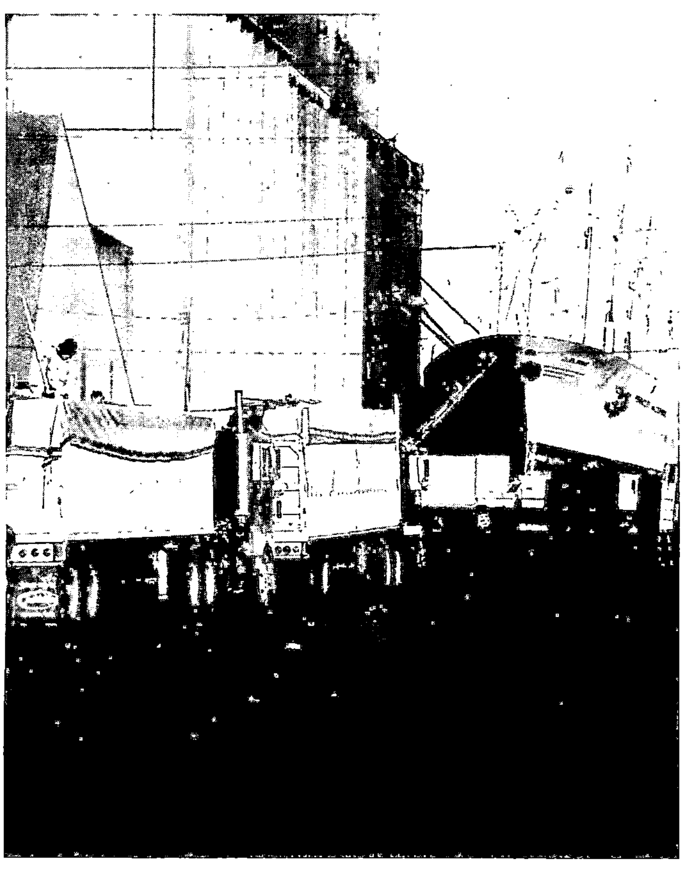
Most trading nations try to restrict imports of competitive goods when they think exporters are dumping excess production into their markets and disrupting normal trade by selling at abnormally low prices. Some exporters try to capture new markets by offering surplus goods internationally at prices lower than internal levels. Export subsidies, multiple price schemes, and tax advantages may be used for this purpose. Special credit arrangements or price concessions on other export items also may be offered to importers. The Japanese steel industry has long been accused of dumping steel into the U.S. market at below-cost prices. In the 1950's and 1960's, some nations viewed our Public Law 480 program as mainly a dumping mechanism for surplus U.S. farm commodities.

Consumers in importing nations typically favor buying world market goods offered at low prices. However, producer groups and domestic merchants often succeed in obtaining offsetting duties, quotas, and special restrictions. These are called "antidumping" measures.

Protect Domestic Program?

When a government supports the market price of any commodity above the world level, some form of import control is required to prevent its being swamped by goods from abroad. This is a typical problem faced by many nations which provide farm income support through high, guaranteed prices.

When a national program is established to set market prices above market-clearing or world levels, the amount supplied to that national market, whether from domestic or foreign sources, normally exceeds the amount demanded for consumption. Unless the government has a bottomless treasury, some means of controlling supplies offered at the support price must be found. Action usually is taken against imports to bring demand and supply into a balance at the support price without resorting to unpopular controls on domestic producers. But even if internal production restraints are used, import controls still are needed to keep the program from being inundated from abroad. Import quotas under Section 22 of the Agricultural Adjustment Act of 1933 have historically provided this protection for a number of price-supported U.S. farm products such as wheat, feed grains, milk, and tobacco.



Protect the Balance of Payments?

When a nation's payments to foreigners persistently exceed its earnings from them, it has an international balance of payments problem. Continuing balance of payments difficulties undermine confidence in the nation's currency and economic strength. As a result the value of the nation's currency decreases relative to other currencies.

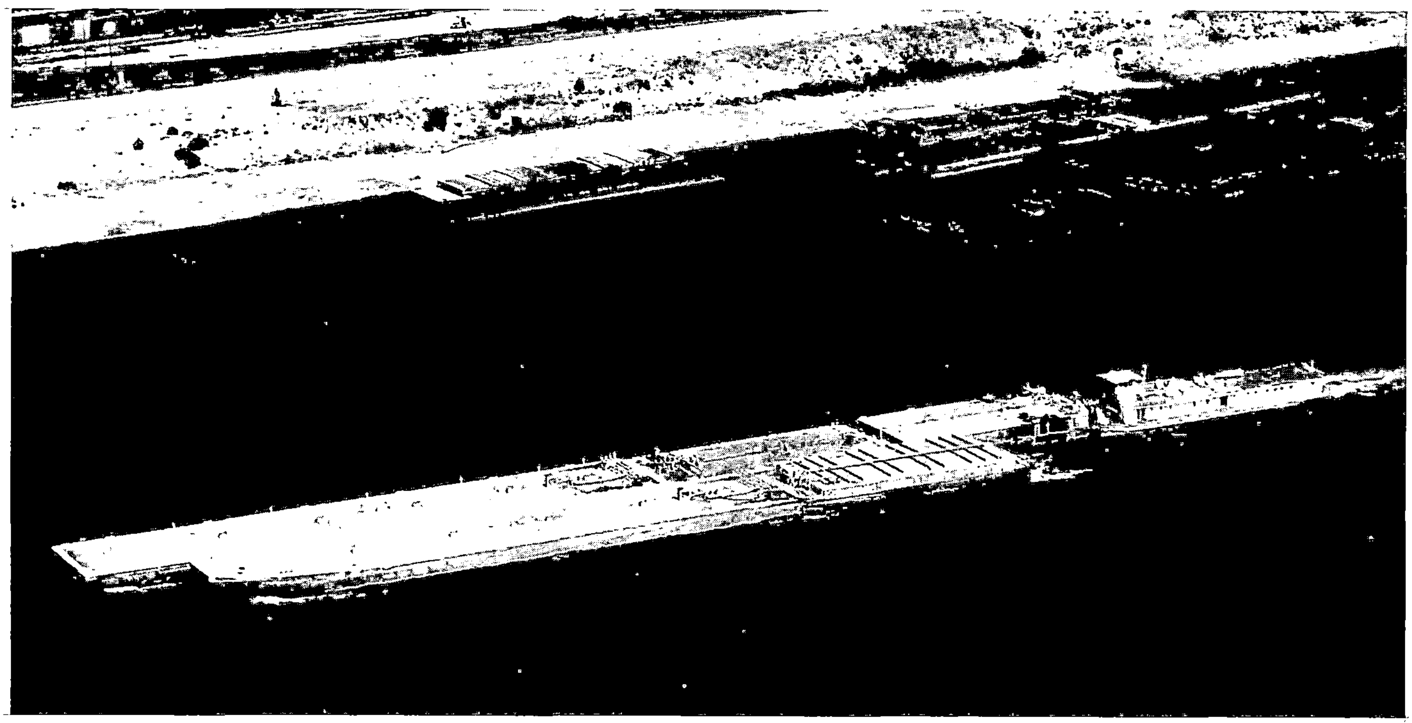
To stave off currency devaluation, a government may try to reduce payments to foreigners by restricting the entry of imported goods. If the nation's export earnings remain the same, the reduction of imports will tend to bring its international payments account toward balance. However, foreign earnings may not stay the same. They may decrease because foreigners, earning less of the restricting nation's currency from imports, may turn to other suppliers for their needs. Also, foreign governments may retaliate by raising their own trade barriers against products from the restricting nation.

Avoid Painful Adjustment?

As economic changes occur around the world, familiar patterns of trading advantage inevitably erode and new ones evolve. Previously strong and vigorous domestic industries may face heavy competition from imports of foreign goods. This is a clear signal for some economic adjustment.

If increased imports and falling domestic prices and sales are caused by growing foreign efficiency, some domestic producers may be forced to go out of business, accept lower returns, or become more efficient themselves. For the people involved, this can be a difficult and painful choice. For resources such as highly specialized buildings and equipment there may be no choice. So, it is not surprising that industry leaders and their representatives first seek government protection when imports threaten traditional domestic markets. Such threats constitute the main reason for the protectionist sentiment in the United States today.

The desire to avoid harsh economic adjustment usually lies behind the drive for new or stricter import controls even though other reasons may be advanced. This is especially true in agriculture and the other basic industries of trading nations, including the



United States. Resources in these sectors are traditionally less mobile than elsewhere. Moreover, powerful economic and technical changes quite apart from foreign competition already are at work within these industries.

To simply accuse adversely affected groups of selfishness, greed, or shortsightedness when those groups propose higher tariffs and tighter quotas is to be naive about the real problems of economic adjustment. Industry jobs lost to import competition are not always similar to open positions in other industries. Nor are they always located in the same geographic area. General unemployment in an economy aggravates this situation even further. Specialized machinery, buildings, tools, and other facilities may be rooted permanently in the affected industries with no alternative uses. They will continue to be used even at low returns until they wear out. But we must remember that protecting an industry from unpleasant resource adjustments means that we sustain long-run costs and inefficiencies throughout the economy.

WHY EXPORT LIMITATIONS OCCUR

Sometimes nations protect domestic consumers or users of an export product by policies that place a wedge between export sellers and foreign buyers. Export taxes, controls, or embargoes reduce export sales below open market levels, bottle up supplies in the local market, and keep domestic prices lower than they would be otherwise. The purpose is to nullify some of the competition for available supplies generated by overseas buyers and to keep domestic prices low.

Like import tariffs, export taxes have a long history as revenue-raising levies for governments which do not or cannot rely on income taxes or other sources of funds. Many less-developed nations, especially primary-commodity producers, depend on export taxes for revenue. Exports of coffee, tea, bananas, ores, and many other commodities are taxed as they leave the producing nation for industrial-nation destinations. (Incidentally, the U.S. Constitution specifically bans revenue-generating export taxes. The cotton- and tobacco-growing states in the Old South insisted on this ban.)

Along with revenue motives, some nations have used export taxes to give price advantage and protection to local consumers. The long-standing rice export tax of Thailand is an example. As the dietary staple, rice is crucial to the Thai people. Their governments through the years have not hesitated to intervene in markets via export taxes (and other measures) to maintain low internal rice prices.

Export controls or embargoes are the counterparts of import quotas. Their results are similar to export taxes because they lower domestic prices and insure more abundant internal supplies. These measures most often are invoked when internal prices are rising rapidly or when domestic supplies seem to be getting critically short. Export controls for farm products may be used to offset domestic supply or price instability caused by fluctuations in weather or other natural phenomena. A further goal may be to protect and insulate intermediate sectors from instability in their input markets. For example, export controls on soybean meal might be proposed to mitigate severe fluctuations in feed costs for producers of hogs, cattle, and poultry.

Sustained export protection of this kind, while popular with consumers or intermediate users of a product, places a burden on the economy by encouraging a long-run misallocation of productive resources.

GAINS AND LOSSES

Just as we should understand the economic difficulties faced by people and industries under heavy pressure from imports, we also need to appreciate the wider costs that protectionism can impose. Benefits of a higher tariff or a tighter import quota in increased sales, more employment, and higher earnings flow directly to the protected domestic industry. While these benefits are pinpointed, the costs (higher prices and lower quantities) tend to be spread thinly over the economy with hardly anyone being damaged very much. Yet, the *total* costs borne by the society through higher prices and narrower choices can be quite large. In general, these costs will exceed the benefits.

This fundamental inequality in costs and benefits gives an edge to industry groups, labor organizations, and producer associations who press for protection. They can identify import competition specifically and articulate their problems clearly. In addition, they can exert political pressure on their own behalf. The diffused voice of the general public is hard to hear. The political power of broadly based citizens' groups, though growing, is not overwhelming.

One way that import protectionism is held in check is through political pressure exerted by industries, workers, and communities heavily dependent on exports for sales, jobs, and income. It is easy to see that if foreign countries cannot sell to us, they will have fewer dollars with which to buy products from us. They may even retaliate with new tariffs and quotas of their own. The fact that direct economic benefits of exports also are concentrated helps to deter ever-increasing import protectionism.

Nevertheless, it is not unusual to hear organizations and individuals support the expansion of exports in which they have an interest and, at the same time, encourage the control of competitive imports. Several U.S. farm organizations do this regularly mainly because they represent a broad cross-section of producers whose commodity interests vary greatly.

Clearly, U.S. growers of grains, oilseeds, cotton, and tobacco are fully aware of their dependence on exports for strong prices and incomes. About one-third of all U.S. output of these items is exported. Yet producers of beef, pork, sugar, milk, and some fruits and vegetables detect significant import competition for their markets, and they seek protection. Consequently, it is misleading to speak too generally about U.S. farmers' economic interests concerning world trade. It is a mixed picture.

As a whole, agriculture is strongly benefited by exports. In fiscal 1978, for example, total agricultural exports were more than $27 billion, about 25 percent of gross farm sales. On the other hand, those agricultural imports directly competitive with U.S. farm output were less than $7 billion. But farmers' interests are fragmented among numerous commodities and geographic regions. As specialization continues among farmers and among regions, we can expect this fragmentation to continue. Hence, bitter disputes about the merits of freer trade will continue. The U.S. economy as a whole benefits from agricultural exports. That $27 billion of annual foreign earnings is crucial in our international payments account. It goes a long way toward offsetting the annual cost of oil imports, which is now more than $45 billion.

CONCLUSION

Farmers and industry people find that their *immediate* economic interests are affected by world trade if they produce export goods or items that are imported. In the first instance they favor freer trade and the expansion of international commerce. In the latter case, they may seek protection to insulate their particular markets and jobs from the full force of international competition. In formulating national trade policy, these pressures should be balanced with each other and with the broad interests of the general public. It is not an easy task.

Consumers and workers *as a whole* **have a strong interest in freer trade even though some individuals and groups may be injured in the process. Consumers are best served by easy access to the world's goods at prices offered by efficient sellers. A nation's people are best employed when economic activity moves toward those industries where productive efficiency is high. These are usually export-oriented industries. As Benjamin Franklin once said, "No nation was ever ruined by trade."**

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Reference Handbook Available:

Speaking of Trade: Its Effect on Agriculture, National Public Policy Education Committee Publication Number 6, may be obtained from your state Cooperative Extension Service. Single copies are available for $1.50 per copy and may be ordered from the Agricultural Extension Service, University of Minnesota, Room 3 Coffey Hall, 1420 Eckles Avenue, St. Paul, Minnesota 55108. Order Special Report No. 72. Prices for quantity orders are available upon request.

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