Carol Bookins on The Embargo Study

Domestic Policy Response Caused Long Term Damage

The conclusion of the embargo study released in November 1986 has created a controversy in the U.S. agricultural community. Critics most frequently charge that the study failed to emphasize the damage done to the U.S. reputation as a reliable supplier in world grain markets. However, more significantly, the study failed to emphasize the effect of domestic agricultural policy changes implemented as a result of embargoes.

In assessing the effect of embargoes on the U.S. position in world markets, those economists who contributed to the study concluded that: (1) macroeconomic conditions in the 1980's—global recession, high U.S. dollar and high real interest rates—were a greater cause of lost U.S. market share than the embargo; (2) domestic programs implemented to insulate American farmers from the cost of the embargo were more than successful in protecting farm income over the short term; and (3) mechanisms used in basic farm policy to provide price and income support for the U.S. farm sector over the past 15 years ultimately contributed to the loss of markets by supporting world prices.

Domestic Policy Response

Each of these arguments individually appear to be empirically correct. However, the broad conclusions reached do not sufficiently take into account the interrelationship of the domestic policy response to the Soviet embargo in 1980 and ensuing loss of U.S. export competitiveness.

Agricultural policy is a response mechanism designed to alter or change the agricultural economy. Policy initiatives often are driven by short-term political considerations or crises; the objective most frequently is to protect or improve farmers' income. A foreign policy decision like the Soviet embargo created a political crisis in the farm sector; it triggered a series of domestic agricultural policy actions designed to counter the negative political and economic effects on U.S. farmers.

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The 1980 embargo additionally was announced at the start of a presidential election year, which further intensified the political crisis due to economic losses facing farmers in the marketplace. At issue is whether domestic policy actions taken in 1980-81 did long-term damage to the U.S. position in world markets by distorting price and income support levels.

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Wheat Policy Response

Briefly examining the policy response on wheat, for example, loan rates were raised during 1980 following the embargo from $2.35 to $3.20/bushel—or nearly 30 percent. The $2.35 loan had been in effect since the passage of the 1977 Agricultural Act. So, $3.20 became the new loan "floor" level during the debate of the 1981 agricultural law which raised the minimum loan rate to $3.55 for the 1982 crop. The study claims that loan rates in the 1981 Act would have been increased even without the 1980 embargo, because they needed "inflation adjustment." But, what would the minimum loan rate in 1981 have been, without the post-embargo loan rate increases designed to counter falling markets? More specifically, if $2.35 had been the basic loan level in 1981, would legislators have raised the minimum loan rate by more than 50 percent in the 1981 Act?

Secondly, Congress responded to the loss of farmers' income from the markets' post-embargo by raising the minimum target price in the spring of 1980 to $3.63 from a $3.08 statutory minimum, and a $3.40 effective target price for the 1978 and 1979 crops. This too set a higher base for the 1981 agricultural debate. The target price was below the season's average price in both 1979 and 1980; however, since 1981 it has remained well above that market price level, raising substantially the cost of farm programs and resulting in such initiatives as the 1983 Payment-in-Kind (PIK) to try to reduce record stocks and payments.

And, thirdly, to further support the high target and offset potential budget outlays, the Administration changed the function and operation of the Farmer-Owned-Reserve (FOR) into a price support and major supply management mechanism. Policy changes both permitted and encouraged producers to carry an unlimited amount of stocks in the FOR through price and storage incentives. This created a secondary and higher level of price support for other world producers.

Effects on Other Countries

Other exporting countries were encouraged to expand their production by the high prices of the late 1970's, by the potential for additional sales in the Soviet market, and by the high U.S. price support structure after 1980. This expansion, we all know, occurred at the very moment of a major global economic reversal.

It is actually a coincidence that U.S. domestic farm support programs were raised to offset the embargo's effect at the start of the world's anti-inflation drive. U.S. farm policies exacerbated the adverse effects of macroeconomic conditions.

In all fairness, the embargoes of the past 15 years are not solely responsible for the recent problems in American agricultural trade. Yet, the political crisis management of the 1980 embargo did lead to domestic policies which heightened distortions in the world agricultural economy. A conclusion on which all can perhaps agree is that the political economy of American agriculture is an area that warrants much greater study. C