Improving Global Trade in Agriculture

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Abstract: Countries should use the least cost alternative either to produce food or to allow resources to flow to sectors that can generate necessary foreign exchange to import food Pressures to export more and import less are apparent and suggest that investments may be taking place in import substitution as well as export promotion Greater emphasis should be placed on flexible policies that emphasize stabilization of medium- and long-term expectations of both private households and firms with respect to their trading and monetary environments. International trade policies should be matched in each country with domestic policies that facilitate international flows of commodities. The roles of the international institutions—IMF, World Bank, and GATT—should be re-examined functionally and organizationally in the Bretton Woods spirit of cooperation

Introduction

Global macroeconomic conditions and policies have had a greater influence on agricultural production and trade in the current decade than in any period of the recent past. To put the current situation in perspective, this paper reviews the divergent conditions and trends that profoundly affected the global economic situation at the beginning of 1980 and the direction that international agricultural trade and production have followed since.

In the post-World War II period, world gross product and trade grew steadily. Under the leadership of the international institutions (IMF, World Bank, and GATT), the fundamental rules of the game were developed, and the framework for institutional management created. In that environment of stability, the international trade and payments system flourished. In the early 1970s, the world shifted from fixed to floating exchange rates, and OPEC provided the world with the first of two oil price shocks. The fourfold increase in the price of oil accompanied a phenomenal increase in international liquidity.

Neither national governments nor international organizations had mechanisms for recycling petrodollars. Commercial banks filled the void by increasing lending to the less developed countries (LDCs) and centrally planned economies (CPEs) at an average annual rate in excess of 20 percent during most of the 1970s. With that newly created source of external funds, the necessary adjustment to the oil price increase was softened and in some cases completely masked. Economic growth remained respectable, consumption increased, and some productive investments occurred. However, with the industrial countries maintaining expansionary monetary and fiscal policies, inflation rates became at least annoying. Nevertheless, trade increased dramatically.

The implications for agricultural trade and production were significant. For example, increases in world wheat and coarse grain consumption led to world trade in wheat expanding in 12 of the last 15 years and trade in coarse grains increasing in 16 of the past 22 years. That growth in world import demand for agricultural commodities came from two primary sources, the CPEs (USSR, China, and Eastern Europe) and the middle income developing countries. Japan's imports grew at a slower pace and those of Western Europe declined. Imports of the OPEC countries increased rapidly towards the end of the 1970s.

The major factor influencing the growth in import demand by the CPEs and the middle income developing countries in the 1960s and 1970s was the economic growth occurring in those countries. The balance of payments accounts of many of the developing countries were deteriorating because of the oil shocks of 1973 and 1979, but the commercial banks stepped in to recycle the OPEC dollars to the CPEs and middle income developing countries. Debts of those countries, therefore, increased, not just to cover investments in plant, equipment, and infrastructure, but also to finance imports of oil, food, and other consumer goods.

In 1980, several events occurred that brought that trade and economic growth to a halt. First, as a result of tightened monetary policies put in place to stop inflation, a worldwide economic downturn occurred. That slowdown was led by Western Europe and the USA and resulted in a decline in demand for primary material inputs to the manufacturing sector, which were traditionally export items of the developing countries. US and world interest rates (both nominal and real) increased. Those countries with balance of payments problems thus found themselves in severe financial crises. Most of their debt was tied to floating interest rates, and, as a consequence, the resulting higher interest payments caused their balance of payments to deteriorate further into the red. Countries such as Poland were unable to meet even the interest payments on their debt in 1980. Since that time, the number of countries facing financial problems has grown to include almost all those of Latin America, Eastern Europe (except for the USSR), and major importers in Asia and Africa. Thus, the economic slowdown has led to a downturn in world market growth, which in turn has been exaggerated by the debt situation and balance of payment problems in a large portion of the world trading system.

Protectionism followed a path that parallelled the rise and fall of trade as well as the problems in the payments system. The trend toward greater reliance on protectionism and away from the free market system developed rapidly after 1980. For most of the post-World War II period right through the 1960s, protectionism was not a major problem; agricultural trade grew steadily. International monetary relationships were stabilized through the Bretton Woods Agreement and operations of the IMF. Several successive rounds of trade negotiations resulted in sharp reductions in industrial trade barriers. As a result, an unprecedented growth in the international economy occurred, and agricultural trade grew steadily.

But changes occurred during the 1970s that altered the framework of international commercial relations. In 1971, the USA repudiated its obligation to redeem US dollars in gold, resulting (by 1973) in the switch from fixed to floating exchange rates. The relative importance of petroleum trade increased dramatically. The move toward floating exchange rates destabilized international monetary arrangements and greatly increased the importance of international capital markets. Short-term flows of funds to take advantage of fluctuating currency values and relative interest rates increased greatly. Higher oil prices resulted in the development of major trade deficits by many oil importing countries and increased pressure for restrictive trade arrangements to offset the deficits. International lending increased phenomenally to oil importing and exporting countries. Oil exporting countries based their expected repayment capacities on the continuing upward spiral in revenue from oil exports.

Those international flows of funds resulted in a massive transfer of incomes among countries and seriously destabilized the international trading system and international capital markets. A significant portion of the income transfer was from industrial and oil deficit LDCs to low population Middle Eastern oil producing countries where import markets for food and agricultural production are limited.

The expansion and inflationary period of the 1970s has in turn been followed by the onset of a long deflationary cycle for the 1980s. The duration of the worldwide recession, the large balance of payments and international debt problems, and exchange rate movements are escalating the number of disputes coming before GATT by countries hoping to improve their international competitive position. While protectionism is on the increase in the 1980s, the world community has never faced up to the task of establishing workable rules for agricultural trade. No round of multilateral trade negotiations since the GATT was established has treated agricultural trade in a definitive way. The Dillon, Kennedy, and Tokyo rounds addressed the issue of tariffs and the control of subsidies in manufactured goods, but, on the agricultural side, recommended that groups be formed to "study and recommend" solutions relevant to agricultural issues.

In sum, both industrial country and LDC monetary policies adopted in the 1970s have had significant effects on the markets for agricultural commodities. The recession in the 1980s has led to further declines in LDC import growth due to the inability of LDCs to expand their exports. The situation shows signs of deteriorating further if countries follow protectionist policies. Those policies not only affect the flow of goods between countries imposing protectionist measures but also affect other countries that depend on exports.

Another area of concern is the extent to which monetary policies influence international commodity prices through their linkages; i.e., economic activity, inflation, and interest rates. The demand for primary goods (and thus commodity prices) is affected by changes in the macroeconomic environment of the major importing countries as well as by the supply of the particular good. But, through most of the post-World War II period, macroeconomic changes posed few problems as the world experienced relatively stable economic growth with fixed exchange rates under the Bretton Woods Agreement. The major focus during that period was development of domestic and international arrangements to stabilize markets from fluctuations in supply.

With the demise of the Bretton Woods Agreement in 1973, international commodity prices became extremely volatile. But only after the recessionary 1980s did countries begin to question whether supply shocks were the primary culprit or if the villain might be macroeconomic factors. For example, as interest rates increase, the demand to hold commodity inventories decreases and drives commodity prices down in an inverse relationship. The growth in OECD money supply is directly correlated with the level of commodity prices.

Economic recession and balance of payments problems have caused many countries to undertake austerity programmes—one element of which has been currency devaluations. Although currency devaluation is often used in attempts to maintain international competitiveness, devaluation results in a higher local currency cost of dollar denominated debt and a higher local currency value of dollar denominated goods in the international market. Devaluations, in the aggregate, are partly responsible for lower international commodity prices.

While one usually expects the prices of primary goods to rise in a period of economic recovery, the current recovery outside the USA is unevenly spread around the globe. Economic growth remains limited in Western Europe, Latin America, and particularly Africa. The slow recovery in Europe is restraining demand and further depressing the prices of international commodities. In the USA, the structure of the recovery—mainly in high technology and services—adds little to the demand for those commodities. Thus, the limited nature and the structure of the recovery as well as the aggregate LDC currency devaluations are depressing international commodity prices.

LDC debt, a large proportion of which is denominated in US dollars, has required more use of local currency as the US dollar continues to appreciate, which, in turn, has curtailed trade by countries that have been forced to substitute debt service payments for imports out of their scarce foreign exchange. Those countries comprise a majority of the total number of countries in the world. LDC attempts to reduce government spending can then be thwarted by rising interest rates, which also has implications for expenditures in the agricultural sectors of many LDCs.

Particularly in the LDCs, investment in the food and agricultural sector may or may not be at appropriate levels as governments attempt to reduce public sector expenditures. FAO estimates that, during 1974-82, per capita food production for developing countries as a whole rose one percent per year. Recent USDA findings for the period 1966-83 indicate that of 106 LDCs, 69 percent were characterized by decreasing trends in domestic food production relative to domestic food consumption on a per capita basis. The FAO study suggests the anomaly of the 1970s, whilst the USDA findings illustrate the inherent difficulties in aggregation. As world economic difficulties continue, the principles of comparative advantage and economic interdependence should guide agricultural investment decisions.

Countries should use the least cost alternative either to produce food domestically or to allow resources to flow to sectors that can generate necessary foreign exchange to import food commercially. A direct relationship exists between LDC economic growth, per capita incomes, and agricultural imports. The World Bank, however, projects that the ratio of import growth to economic growth during 1980-85 will be only 54 percent of the 1973-79 average. The implications are that, whatever the level of investment, the pressures to export more and import less are apparent and suggest that investments may be taking place in import substitution as well as export promotion. Such investments could be extremely detrimental to a country's longer term development.

Recommendations for Improving World Trade and Production

The downturn in world market growth, trends toward greater protectionism, declines in commodity prices, the capital shortage, and the debt problems can be traced to changes in domestic policies of certain countries and to failures of the market system. Disruptions of the international finance and world agricultural trading systems in recent years clearly illustrate the importance of the structural issues of debt, protectionism, exchange rate volatility, and effective monetary and fiscal policy coordination, both within and among nations. Since many of those difficulties appear unlikely to improve in the immediate future, countries must recognize the impact of their domestic macroeconomic and agricultural policies on other countries as well as the impact (both structurally and competitively) on their own economies. Therefore, we must focus on available alternatives.

Greater emphasis should be placed on flexible policies that emphasize stabilization of medium- and long-term expectations of households and firms with respect to their trading and monetary environments. Conflicting signals due to governments pledging themselves to resist protectionism and then imposing import restrictions or market-sharing arrangements on their trade partners contribute little to restoring confidence in their economies. A combined effort of major countries to work toward eliminating protectionism could result in greater market access of the heavily indebted countries and their ability to earn foreign exchange for debt servicing. At the same time, such an initiative would strengthen confidence in the international financial system and alleviate some of the uncertainty.

International trade policies should be matched in each country by domestic policies that facilitate international flows of commodities. Some forms of domestic policies disrupt world agricultural markets more than others. Domestic policies that limit the extent of foreign access to their markets or provide open-ended export subsidies involve greater costs than those that target income support to particular areas of the agricultural sector. Governments that encourage domestic policies that allow market forces to operate will encourage development of their agricultural sectors to meet those demands with the least cost. If governments choose not to set their policies in such a manner, both importers and exporters of agricultural commodities will bear additional economic costs.

Macroeconomic policies that support and enhance economic growth and, in turn, enhance growth in demand for agricultural commodities should be adopted. Monetary and fiscal policies must be coordinated and must facilitate stable private sector expectations in such a way that the market and profitability guide resource allocation decisions rather than short- or long-term government interventions. In today's world, where interest and exchange rate markets are separate entities, financial instruments and arbitrage are often more profitable than physical investments, leading governments to become more (rather than less) interventionist as the pressures increase to finance domestic public budget deficits on the one hand and to protect against capital flight on the other.

The global institutional framework that guided economic relations during the stable prosperity following World War II is in disarray, as is the cooperative spirit with which such institutions were created. The intent of the architects of the Bretton Woods institutions was that IMF would provide international liquidity, GATT the rules of trade, and the World Bank the international lending for economic development. During the turbulence of the 1970s, the World Bank and IMF modified their roles in an attempt to adjust to the changing environment, and the character of both institutions has changed from the founders' original intent. GATT, however, being an agreement among nations rather than an institution *per se*, was unable to make modifications as the world environment changed. That left GATT incapacitated and unable to mediate trade disputes or enforce the rules. The role of those intended-to-be interdependent organizations must be rethought functionally and then organizationally in the Bretton Woods spirit of cooperation.

Note

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Discussion Opening—*Juan Carlos Martinez*

One of the features of the model in Crocomo and Crocomo's paper with implications for the results is the treatment of technological change. Yields were held constant in the first scenario and assumed to increase between 1.0 and 2.5 percent annually in the second scenario. The most dramatic consequences of the removal of restrictive policies are the elimination of the maize deficit (projected in the first scenario at 10 Mt in 1995) and the reduction of wheat imports from 6 Mt to 4 Mt. Note that in both cases consumer subsidies of wheat were removed, implying a lower per capita consumption of wheat flour.

Recent work done at CIMMYT with primary data for 1980/82 for Brazil's maize and wheat crops indicates that whilst wheat consumption has been subsidized, wheat production has been protected. Accordingly, policy circumstances associated with wheat do not fit well in the general framework of policy discrimination against the agricultural sector, raising some questions about the policy implications of the results of the second scenario. The increase in wheat production is associated with increases in market distortions and protectionism. No explanation is provided by the authors in relation to that apparent inconsistency in the nature of the policy changes proxied through the model. How would the results have been different in an alternative scenario more consistent with the principles of comparative advantage?

In Nwosu's paper, no major increases in supply follow the dramatic price shift. The explanation offered is that "...huge increases in the prices of factors of production have made crop production less profitable." However, no evidence of relative prices (agricultural input/output) or even real prices (deflated by an inflation index) is presented.

General Discussion—*Dharam Ghai*, Rapporteur

The discussion from the floor covered three main issues: trade and protectionism, the interaction between domestic and international economic policies, and the role of international financial and trading organizations. Is it correct to attribute falling US agricultural exports to protectionism in Europe? Could the increasing use of countertrade in international transactions be a means of increasing international trade? To what extent is protectionism really due to rising productivity and surpluses and not to other factors? Is it protectionism or the threat of protectionism that is on the rise?

For a number of reasons, oil-dependent countries like Nigeria and Iran cannot easily raise agricultural exports. Both the threat of and protectionism itself are on the rise; countertrade has increased from 7 to 20 percent of world trade and is especially important for some developing countries. Nigeria has no choice but to increase food production and agricultural exports.

If international policies were adapted to domestic ones, disastrous consequences would ensue, given the large deficits many countries are running. Social costs are high of adhering to the rules of international trade in the form of unemployment, environmental problems, and rural poverty. Domestic policies have international implications that should be taken into account.

Would reform favour commodity-producing countries? Is the real need not the necessity for structural changes in both developed and developing countries but rather the reform of international agencies? In view of large changes in trade, liquidity, and debt in recent years, we need to rethink the structure and role of international financial and trade agencies to enable them to cope better with contemporary world economic problems.

Participants in the discussion included J Berthelot, M.R Ghasimi, A Ikpi, M Petit, and B.E. Prentice.