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FUTURE OPTIONS FOR U.S. AGRICULTURAL TRADE POLICY

by
Vernon L. Sorenson*
and
George E. Rossmiller*

Introduction

During the 1970s unprecedented change occurred in the international market for agricultural products. Exports became a major source of market growth for U.S. farm products and reached a peak of nearly $44 billion in 1981 before falling to $39 billion in 1982 and to a forecasted $34.5 billion for 1983. This growth in the 1970s had a profound impact throughout the U.S. food system and resulted in a phenomenal increase in interdependence within and among trading nations.

The policy consequences of increased international interdependence are important. The impact of policy decisions extend far beyond the commercial question of establishing international exchange among nations. A decision concerning international trade policy can affect rates of economic growth and the distribution of income among nations and among groups within the United States. Trade policy can make or break industries, affect living standards and the use of resources in disparate parts of the world.

Trade policy like all public policy must reflect political realities. It is an area where opposing philosophies collide concerning the role of free markets versus the need for government intervention. Agricultural

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*Professor, Department of Agricultural Economics, Michigan State University, and Director, Planning and Analysis Staff, Office of the Administrator, Foreign Agricultural Service, U.S. Department of Agriculture respectively.
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trade policy is almost always forced into the role of supporting domestic policy due to the assumed sovereign right of most governments to follow farm policies that reflect primarily their domestic interests as opposed to accepting the need to make concessions that improve the functioning of international agricultural markets and move toward improved world economic welfare.

It is, thus, within the framework of a broad set of values that extend into many aspects of international affairs and deep into the affairs of nations that agricultural trade policy must be developed and against which its adequacy must be judged.

The Meaning of Interdependence

What is the nature and meaning of the interdependence that trade generates. Interdependence is first a two-way phenomena. U.S. dependence on foreign markets is matched by dependence in foreign countries on U.S. supplies. For example, it is no wonder that Japan worries about the U.S. as a reliable supplier since more acreage in the U.S. than in Japan is used to supply food to Japanese consumers. But the flows of trade as such are not the most relevant indicator of the implications of interdependence. The dimensions of trade policy are not determined at national boundaries where trade itself is perceived to take place. Trade policy problems flow from the framework of dynamic interaction among mixed economies where national goals related to economic growth, employment, income growth, etc. exist and where these goals are furthered by policy intervention. These interventions often create conflict among nations, and these conflicts must be fought out and if possible resolved in international fora. This is the real meaning of interdependence. Therefore, to understand the impact of government action on trade, the linkages and policy initiatives throughout the economy of which trade is a residual, albeit essential part, must be taken into account.

The implication is that policy needs to be viewed as a composite of domestic and international actions and must be collectively judged in the light of the impact on society as a whole. Further, it cannot be concluded that all policy intervention is bad and that the only relevant goal is to simply reduce or eliminate government intervention. The United State does not accept this position nor does any other nation. Policy must be dealt with in the context of dynamic interactions among nations in which gainers and losers emerge. These gains and losses must be simultaneously dealt with both in the domestic economy through the political process at home and internationally as part of foreign economic policy.

Trade Policy Objectives

Defining the appropriate objectives for trade policy in this context is a difficult task. In its broadest sense the ultimate test of adequacy is how well trade policy serves the (long term) national interest. But the national interest is an abstract evolving concept that cannot be specified in detail at any point in time. It is not the sum of various and divergent parochial interests that tend to equate the national interest to their own and exert as much political pressure as possible to achieve their ends.

Criteria, thus are necessary to evaluate future policy options.[1/] Relevant performance criteria include economic efficiency, economic growth, equity, economic security and market stability. While these broad criteria are the same as would apply to evaluation of domestic policy, the political and economic diversity that exists in the international setting requires a much more complex conceptual framework. Efficiency, for example, is affected by differences among countries in customs and practices, available technologies, political systems, and levels of education and economic development. The related objectives of growth and expansion are also important in international markets. However, where growth should take place and how its benefits are distributed become issues with a strong component of national interest and over which significant conflict arises.

Equity is an emotional question in developing domestic policy and is equally difficult at the international level. The clammer of LDCs for a new international economic order illustrates the importance of this question. A basic argument is that for a number of reasons related to differences in the structure of economies and markets, LDCs are disadvantaged. This in turn is reflected in deteriorating terms of trade and the inequitable sharings of gains from technological progress.

Economic security is an important objective of all nations. Most nations are unwilling to fully subject their economic security to the economic and political forces of other nations through total openness to the international market. Many nations are willing to accept reduced growth and perhaps even a lesser degree of equity in order to maintain an acceptable level of economic security.

A related issue that contributes to economic security is that of market stability. Again most nations through various mechanisms protect themselves to varying degrees from the instability that arises through dynamic supply-demand imbalances in the international market. Unfortunately the very act of such protection often further exacerbates the instability in the international market.

Differences in philosophical orientations and values among nations lead to the assignment of different weights to these and other relevant objectives. This, in turn, creates rigidites and conflicts that impede movements toward solutions to problems in the international trading system. Further, interdependence subjects agricultural industries to adjustment pressures based on global weather patterns and policy and economic changes throughout the world and over which individual governments have no control. Since adjustment is difficult under these conditions, increased pressure is brought to bear on governments to raise protection levels, further complicating the process of international policy formation.

Future Economic and Political Environment

Evaluation of future policy alternatives requires the assessment of the economic and political environment that will apply. For most of the post World War II period through the 1960s agricultural trade grew slowly but steadily. International monetary relations were stabilized through the Bretton-Woods agreement and operations of the International Monetary Fund. Several successive rounds of trade negotiations resulted in sharp reductions in industrial trade barriers. As a result there was an unprecendented growth in the international economy.

But changes occurred during the 1970s that altered the famework of international commercial relations.[2/] The most important of these are: (1) in 1971 the United States repudiated its obligation to redeem U.S. dollars in gold, and (2) 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 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 these deficits. In addition international lending increased phenomenally both to oil importing countries and to oil exporting countries who based their expected repayment capacity on a continuing upward spiral in revenue from oil exports.

These 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 population short mid-east oil producing countries where import markets for food and agricultural products are limited at best.

The expansion and inflationary period of the 1970s has in turn been followed by the onset of an apparent long deflationary cycle for the 1980s. This recessionary cycle has been exacerbated by a change in policy particularly in the United States that has placed central emphasis on reducing rates of inflation. High oil prices led to unexpected conservation in energy use and some of the developing countries that became heavily·indebted during the 1970s face a situation of declining export earnings and excessively heavy debt burdens, in some cases at a critical level. Lenders have become more conservative and a world-wide retraction in lending seems to have begun.

Net new credits to the less developed countries increased on average 20 percent per year during the 1970's. Bank for International Settlement (BIS) data indicates the need for $54 billion in foreign exchange earnings or new loans to service the present $420 billion short and intermediate term outstanding debt of the less developed countries and the centrally planned economies. But the net new credit flow to the LDCs during the final quarter of 1982 dropped slightly over 50 percent from the 1981 rate. This demonstrates the curtailment of international lending to the LDCs. Further, in recent months the Eurodollar market shrank by $19 billion as the OPEC countries withdrew petrodollar deposits to finance their own balance of payments deficits. From the 21 major LDC borrowers, short and medium term debt service presently requires about 80 percent of their foreign exchange earnings. A major contributing factor has been the decline in real prices of LDC major commodity exports of 13 percent in 1981 and a further drop of 17 percent in the first three quarters of 1982.

The implications of these changes for future policy formation are profound. Because heavy debt burdens have been accumulated in many countries, massive debt payments will result in a continuation of income transfers for years into the future. These phenomena will affect general economic growth and development rates in many countries and create short-term balance of payments pressures that will be internally accommodated through reduced foreign market purchases. International debts can be repaid only through exports or returns on foreign investments. A particular burden, thus, exists on industrial countries and well-off LDC exporters which include primarily mid-east OPEC plus a few rapidly growing LDCs such as Taiwan and Korea to liberalize trading arrangements and permit readjustment of the world's capital and debt structure. This change will not be easy to achieve.

As increasing numbers of countries come under IMF strictures, conditionality terms imposed will likely in the aggregate curtail imports, including those agricultural. An important longer term issue is whether the balance of payments constraints faced by many LDCs along with the IMF imposed austerity measures have structurally changed the former growth and trade relationships between the LDCs and the OECD countries. If such structural change has occurred, the question becomes what is the longer term impact in food importing countries and on their ability to trade.

Beyond this when viewed from the U.S. perspective other important changes have occurred. One of these reflects the internal problem of productivity in the United States industrial economy. The loss of international competitive position by American industry has resulted in a strong drive for protectionism that has the potential of reversing the post-war movement toward freer international markets. The proposed local content legislation, restrictions on textile imports, and the recent imposition of import curbs on steel are examples.

Unfortunately such protectionist measures strike at some of the larger U.S. markets for agricultural products. The restriction of textile imports from the PRC has resulted directly in the reduction of U.S. agricultural exports to the PRC as they have retaliated by diversifying their sources of supply for agricultural imports. Such events have an obvious impact on the ability of the United States to deal with international trade policy for agriculture.

Partly in consequence of this deteriorating competitive position and partly as a result of changes in other parts of the world, the U.S. has lost influence in international commercial relations. We now provide leadership but no longer enjoy the dominant power that once existed. We must now persuade and seek cooperation rather than impose our position. Formation and growth of power centers such as the EC, Japan, the OPEC and our change in relations with socialist countries have created a more balanced international bargaining framework to which we must respond. This is the framework in which we must formulate and evaluate future options available to the United States in agricultural trade policy.

Reducing Trade Barriers

A first question that needs to be asked in discussing future options is whether the United States can continue its thrust toward multilateral reductions in trade barriers, including those in agriculture. The modest gains achieved during the multilateral trade negotiations (MTN) are increasingly subject to strains, both within the United States and externally.

On the export side we face increasing problems of selective import controls and subsidized competititve exports. This has led to a situation in policy that can best be described as one where we are waging a defensive offensive particularly vis-a-vis the European Community. Several GATT complaints relative to EC export subsidies or import protection have been implemented. We recently made a heavily subsidized wheat flour export sale to Egypt and additional such actions are being considered. We also implemented a blended (subsidized) credit program as another means to meet subsidized export competition. This kind of warfare can go on indefinitely and in some some sense probably must. It can have only one of two possible results. Optimistically it could achieve U.S. objectives of exerting the pressures necessary to bring about serious negotiation and solution of the conflicts, or pessimistically it could cause slow deterioration in the world trading framework or even explosion into an outright trade war. It will not by itself provide a long term answer to trade policy problems facing the United States.

A primary element in solving future trade policy problems lies in meshing our domestic agricultural policy to be consistent with our export objectives. We cannot continue to maintain rigid protectionist positions for several non-competitive agricultural commodities (e.g. dairy, sugar, meat) and argue successfully for a world of free trade. Further even in grains policy we are moving in a direction that is having serious international consequences. We have reached the level in loan rates, which in turn underpin world grain prices, that in conjunction with a strong dollar appears to have provided a signal to other exporting countries to expand production. The Canadian wheat board, for example, recently announced a 6.5 percent expansion in wheat acreage.

This kind of a policy can have a drastically different effect than was the case during the 1950s and 1960s. At that time our exports were small and our domestic price levels could be insulated from world markets through import controls and export subsidies. With increased dependence of U.S. agriculture on the export market a return to these former policies is simply not viable. Without a recognition of the need for international competitiveness as domestic farm programs are formulated, the potential exists for other producers to displace the component of U.S. grain production that moves into world markets. In the extreme, this could require supply control to the extent of about 65 percent of U.S. wheat production and about 30 percent of U.S. corn production.

We face a "Catch 22" situation. The United States in establishing the parameters of domestic agricultural policy clearly must recognize the implications this has for setting world prices and hence that loan levels must be constrained. An option is to lower loan rates and continue to maintain target prices at some desired level. This can result in very high budget outlays. The nature of this dilemma, clearly evident from economic analysis, appears finally to be penetrating the political sphere.

The flexibility that the U.S. has in developing domestic policies is also complicated by the current strength of the U.S. dollar. Long-run import demand elasticities are not well know and we cannot judge how state trading countries respond to price, but the combination of high U.S. prices and a strong dollar undoubtedly have an effect on U.S. agricultural exports. In the longer run the strong U.S. currency has implications for supply response in competing countries. With current exchange rates the 1982/83 loan rate on wheat of $3.65 per bushel, for example, translates to a price to Canadian farmers of about $4.40 per bushel in Canadian dollars. U.S. policies are stimulating increased output around the world and especially in competing export countries.

The general conclusion that emerges both in observing policies in other major trading countries and in the United States is that major gains through a further round of multilateral trade negotiations will be difficult to achieve. Following his experience in the Kennedy Round of trade negotiations, John Schnitker argued that agricultural trade liberalization occurs, not as a result of external pressure, but only when nations perceive their domestic costs of agricultural protection to be excessive. This apparently continues to be the case.

Organizing International Markets

Both the LDCs as a group (via UNCTAD) and some developed countries argue that multilateral international commodity agreements (ICA) are the most viable form of international arrangement to organize the market and to reduce instability to acceptable levels. The most compelling argument against ICAs is that none have ever worked out in practice. More specifically ICAs have failed historically to achieve their objective of market stabilization. They are difficult to negotiate. When market conditions are such that producers want to negotiate an ICA, consumers do not and vice versa. They restrict the free flow of commodities in international trade and result in misallocation of resources and economic waste.

An alternative approach that has been suggested by academic sources is to move from our policy of seeking multilateral reductions in trade barriers toward bilateral arrangements. The contention is that the multilateral approach has been carried about as far as possible and that most countries will continue to maintain protective programs. It has been suggested that bilateral agreements with stabilization reserves and perhaps a variable export levy[3/] could be used to provide predictability and stability in major markets.

The use of bilaterals, however, is subject to limitations. As the major world supplier of agricultural commodities the United States is in a unique position in its potential to assure supplies through bilateral arrangements. However, contracting all or even a major portion of U.S. export supplies would result in a complex and cumbersome trading system.

Another issue is whether bilateral agreements can help to stabilize market prices. The price effect of stabilizing the quantities traded through bilaterials is unpredictable and will depend in part on perceptions of emerging world supply and demand conditions. In a short supply market, buyers tend to bid prices up and in a market with plentiful supplies exporters tend to compete through price reductions. In general price variations in a market characterized by extensive government directed trade will be greater than would occur in an unrestricted market.

Another suggested approach is that the United States could coordinate the use of bilateral agreements with an overall program aimed at restricting total world supplies and raising export prices. This would require collaboration with other exporters in the form of an international cartel arrangement.[4/] Effective market sharing arrangements require limiting the quantities flowing into the market in total and by each supplier, a method of enforcing quantity limitations and price agreements among suppliers and a willingness and an ability of suppliers to share in stocking during surplus periods. Achieving these conditions implies a high degree of government market control in participating countries. This level of control does not exist in the United States and at present there is no evidence that imposing this much government control is either politically or philosophically acceptable.

Prospects for the Future

The above discussion does not lead to an optimistic assessment of future policy prospects. We have concluded that neither multilateral reductions in trade barriers with a view toward eliminating government intervention in international markets through rounds of trade negotiations nor extensive use of multilateral or bilateral agreements seeking to control our destiny will be the complete answer for the future. This does not rule out either approach entirely but does suggest that a single valued policy objective function will be inadequate. It implies the need for a flexible approach that seeks to deal with the existing mixture of domestic and international policy from the perspective of the search for improved functioning of international markets, taking into account the relevant performance objectives and constraints that nations face.

The evolving structure of U.S. international markets suggest that the nature of government involvement will change in the future.[5] During the period 1960-80 imports by socialist countries and LDCs increased rapidly. In 1960 these countries accounted for about 40 percent of world wheat imports and about 17 percent of coarse grain imports. By 1980 these percentages had increased to about 90 and 65 percent respectively. The importance of this change is twofold.

First, is the financial question. U.S. agricultural exports to LDCs and socialist countries depends heavily on the financial condition of these food importing countries. Recent developments in their debt positions have made agricultural export credit more necessary and more risky. Somewhere between 30 and 40 countries have or are presently attempting to reschedule existing debt and a significant number of those countries have already missed debt payment. A substantial number of these countries have been growth markets for U.S. agricultural exports. Thus if the U.S. expects to retain and develop these markets on a long term basis the meaning of "reliable supplier" must include a flexible credit program that has the capacity to adjust repayment schedules, if necessary, as part of the total government support package to U.S. agriculture.

Second, all of the communist countries and a large portion of the LDCs handle their international trading relationships through state trading organizations. These state trading organizations often are guided by considerations that do not provide the kind of response that would be expected in a market economy and can represent a destabilizing force in international markets. This implies in some cases the need for close government monitoring of their likely purchases to achieve greater market predictability.

It is also likely that LDCs and CPEs represent the most promising use of bilateral agreements by the United States for selective export expansion in conjunction with market development programs. These could be one-time programs aimed at initiating consumption of particular products in importing countries or they could be long term programs aimed at stimulating agricultural and industrial development within importing countries with a view toward long-term growth in their food import needs. The opportunity for short-term export expansion, as is implicit in our current agreement with China, may be somewhat limited and is in part dependent on improvement in processing and distribution facilities within importing countries. Greater potential may exist in linking long term expansion in selected countries to the role that food can play in overall economic development.

There is good evidence to conclude that a secondary impact of economic development is increased food imports associated with rising income. The dual objectives of achieving higher incomes in poor countries and expansion of U.S. agricultural exports are consistent. This approach, however, involves a much closer linkage between those U.S. government agencies and private organizations concerned with export market expansion and those concerned with economic development than currently exists.

Another adjustment that would be useful to U.S. policy is to change our perspective on international negotiations particularly the role of GATT. First, efforts need to be made to achieve wider participation. The LDCs participated significantly in GATT for the first time in the recent multilateral trade negotiations. At present only two socialist countries, Yugoslavia and Romania, are GATT members. Wider participation will also require broader GATT coverage in the form of new rules and protocols. For example, the GATT is simply not equipped to deal with the issues and disputes that arise in the normal course of commerce with and among state trading entities.

A main concern with GATT, however, is that its activities have been confrontational based on trade offs of special interest.[6/] This is inherent in the negotiating rounds. Activity in the GATT between rounds of trade negotiations is designed largely to hold the line on efforts by individual countries to increase levels of protection. The resulting interactions center around dispute settlement and also reflect treatment of specific interests.

Most of the basic areas of concern that exist in today's dynamic interdependent world simply do not lend themselves to negotiation in this traditional sense. These areas include:

1. Domestic farm policies and their implications for international adjustment of resource use.

2. The use of direct export credit or production subsidies.

3. The multiplicity of nontariff barriers.

4. Distortions in the international monetary system.

5. The role, potential and limitations of international agreements.

6. The mix of issues encompassed in the LDC proposal for a new economic order.

There is a need to broaden the GATT mandate to deal more effectively with some of these basic issues. Some gain was achieved during the recent MTN through establishing codes to handle certain aspects of the nontariff barrier problem, but no progress was made in developing a safeguards code which is central to achieving international adjustment of resource use. The subsidies code as implemented to date has brought less rather than more discipline in the international agricultural market; renegotiation is being pressed by the United States, so far without success. A substantial effort was made to deal with instability through development of an international wheat agreement, but without success. A multilateral agricultural framework was established. This effort sought to bring high level officials from member governments together for meaningful discussion of proposed farm policy changes that might lead to international conflict. The activity had a short effective life.

It has become clear that the Tokyo Round with its immense media coverage led the public to believe that the GATT is more authoritative and powerful than it turns out to be in practice. Expectations were developed that cannot be fulfilled. In a recent wheat flour case when the panel ruled against the United States we were successful in avoiding GATT acceptance of the report. In a recent pasta case when the GATT panel rules in favor of the United States, the EC managed to keep the report from being adopted. For a variety of reasons the process is simply not working. At present the only effort in the GATT to deal with broader policy concerns is through ministerial level meetings usually called in a crises situation. Even these meetings can turn largely into confrontations centered around specific issues.

Behind any initiatives on the international front is the question of whether we can keep our own house in order. The competitive position or comparative advantage of American farm products on world markets is being jeopardized by three major internal conditions that the United States Government could influence with appropriate policies.

A farm policy based on increasing loan rates and expanded efforts to control supply is self-defeating. At a minimum we cannot sustain income support at a level adequate for marginal over-extended farmers. Loan rates must be lowered and maintained at a level consistent with our international market needs and target prices must be established at levels designed to prevent wide-spread financial disaster among efficient farmers. If further income support is considered justified for marginal farmers, it should be completely separated from the market for farm products. This, of course, is an old admonition expressed by agricultural economists that politicians have completely ignored in the past and they may continue to do so.

The other two components of U.S. agriculture's competitive problem lie outside of the agricultural sector. One is the impact of monetary and fiscal policy. Our present situation with large government deficits and nearly complete reliance on monetary policy to guide the economy presents a dilemma. A tight money policy that controls inflation creates high interest rates, international capital flows and a strong dollar, that in turn penalizes U.S. farm products in international markets. On the other hand an expanded money supply and lower interest rates along with massive government deficits likely will generate inflation and increase agricultural costs which, in turn, will have a negative impact on agriculture's competitive position. Probably no single policy change is more important to maintaining the long run competitive position of American agriculture in world markets than reducing U.S. federal government budget deficits.

The third condition relevant to agriculture's long range competitive position stems from its linkage to U.S. industrial sectors. American policy can turn toward increased protection for non-competitive sectors. Alternatively an effort can be made to stem the exercise of economic power by American industry and labor that leads to non-competitive pricing and provide leadership in establishing a more internationally competitive technological foundation for American industry. A reversal of the recent trend toward deterioration of U.S. international competitive position is imperative to achieving improvement in the general trade policy climate and thus for agriculture as well.

In total the new need in trade policy is to recognize the nature of international and intersectoral interdependence and to develop a set of mechanisms to seek collaborative approaches to problems of international market performance. Conflict arising among nations that affect agricultural trade cannot be solved through the approach implicit in procedures involving rounds of negotiations and confrontation over specific policy actions. While progress may be slow, the search for a more collaborative alternative that seeks to deal with the mix of domestic and international policy in the perspective of mutual national interests is needed.

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