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U.S. Agriculture in the New International Order

by

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Recent events in Central and Eastern Europe are part of a continuing, world-wide political and economic realignment that is important to U.S. food and agricultural industries. The realignment has greater long-run significance for U.S. agriculture than either the new farm bill or the GATT negotiations.

A Changing World Order

Since the close of the second world war, international relationships have been defined by two major military-economic-political blocs -- NATO and the OECD in the West and the Warsaw Pact and COMECON countries in the East. A third group of countries, lacking in global military power and characterized by low per capita income, has usually been referred to as the third world. Significant changes have occurred in each of the two major blocs due to the economic problems that confront the superpowers in each bloc, the United States and the USSR. At the same time, some developing countries have experienced substantial

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economic growth, resulting in a more heterogeneous third world. Thus, the reordering has brought:

1. Disillusionment with communism as a viable option for serving the aspirations of society, not only in the COMECON countries but throughout much of the third world as well,
2. A general recognition that world power and prestige in a techno-scientific age derive more from economic than military prowess, and
3. Formation of three economic blocs competing for international economic supremacy.

Disillusionment with Communism

Events of the past year in Central and Eastern Europe are tangible evidence of the disillusionment with communism. Even if the turn toward democratic capitalism is reversed by military force, pressures for change will reemerge later as the centrally planned economies fall ever farther behind the West in serving human yearnings for freedom of choice and a steadily-improving standard of living.

The road to democratic capitalism in the eastern bloc will not be easily travelled. Socialism in the form of central planning and state ownership of the means of production has not been compatible with political democracy or development of entrepreneurial and managerial skills. Establishing the work ethic and market institutions takes time even if central planning and other impediments to markets are fully removed -- and they likely will not be.

Unrealistic aspirations could outrun political changes and fuel the economic degradation process characterized by excessive debt, inflation, overvalued (non-convertible) currency, and balance-of-payments deficits (Tweeten, *AJAE*, December 1989). Faced with such difficulties, some reforming countries attempting to pursue the Swedish model of the democratic welfare state and capitalistic private industry will revert to what we label the Yugoslavian model -- a state of economic stagnation and factionalism that is somewhere between democratic capitalism and totalitarian socialism.

From Military to Economic Prowess in the 1990s

The underlying causes for restructuring the USSR grew out of recognition that a first-class military, with its dependence on high technology and costly weapons, cannot be sustained by a second-class economy. Additionally, the global extension of military power has contributed to the relative decline of the resource-rich Soviet and American economies.

A current quip is that after more than four decades of cold war between the United States and the Soviet Union the winners have finally emerged: Japan and Germany. By stressing savings, technological excellence, trade, and human resource development rather than military might, Japan and West Germany have become major world-class economies despite relatively small populations and limited natural resources. For example, with a population only one-half that of the United States, Japan equals the United States in numbers of scientists and engineers (*The Economist*, December 2, 1989, p. 4 of "Survey."). In short, Japan's and Germany's world influence and prestige derive in part because they devote relatively little science, engineering, and industrial resources to the military.

Three Emerging Economic Superblocs

While the Eastern Bloc is breaking up out of economic weakness, the West, out of economic strength, is multiplying into three distinct superpowers: (a) Japan, (b) the United States and Canada under the recent free trade agreement, and (c) the EC-12.

Partly to dilute world concerns regarding economic and political intentions of a united Germany, the EC likely will expand to include some of the COMECON countries. Candidates include Poland, Hungary, and Czechoslovakia. However, the EC will be too preoccupied with problems of *Europe 1992* and absorbing East Germany to consider full integration of Central European countries before year 2000. In addition, with the fading of the USSR as a common enemy, the ethnic, cultural and economic heterogeneity of the expanded "western" Europe will work against full political and economic union in Europe. Economic protectionism in Europe could remain throughout this decade justified initially by the need to protect markets while east bloc economies are restructured and in the longer term by Eurosclerosis revived by enlarged social welfare and environmental programs.

Without the military threat from the east bloc, America's military presence and close political ties with Japan and Europe will be difficult to maintain. That sets the stage for bickering over macroeconomic and trade policies and perhaps more serious conflicts between the "New West" and the "New East." These tendencies could be reinforced if the GATT Uruguay Round does not live up to early expectations.

Japan as the smallest economic superpower is especially vulnerable to a European bloc augmented in size and economic power. The seemingly natural free trade area comprised of Japan, China, Taiwan, and Korea (and perhaps stretched to southeast Asia) is beyond reach because of lingering colonial and World War II legacies. In contrast, the search for an enlarged free trade area by the United States and Canada feasibly could include Mexico, Australia, and New Zealand.

Each of the three economic superblocs will possess the wherewithal for breakthroughs in cold or hot nuclear fusion, superconductivity, genetic engineering, and a host of other technologies that have the potential to raise living standards worldwide. This globally-available mass of technology is likely to increase economic competition among the economic superpowers.

The United States and Its Legacy of the 1980s

To be sure, the United States remains the world's premier economic power. However, a world with superpowers bent on competing economically rather than militarily does not mean the United States will flourish. The nation has been weakened by economic policies that will burden the future: a dilapidated infrastructure, financial institution bailout costs, a troubled elementary and secondary public school system, inadequate provision for retirement needs of the baby-boom generation, environmental clean-up, domestic and foreign debt, neglect of civilian science and technology. . . the list has no end.

Responding to the accumulated IOUs of the U.S. economy will be complicated by several factors, including a low rate of savings, general public distrust of science and technology, and further transformation to a slow-growth service economy. Services, now accounting for three-fourths of the economy, are less cyclical than manufacturing but also are less amenable to productivity advances. Growth in real GNP per capita dropped from an average annual rate of 2.5 percent in the 1960s to 1.7 percent in the 1970s and 1.8 percent in the 1980s. The need to divert present and future income to retire past consumption debt suggests even slower growth in the 1990s and perhaps beyond.

The huge federal deficits of the 1980s have reduced the effectiveness of fiscal policy as a major tool for economic stabilization. This places a seemingly impossible burden on monetary policy to steer an economic growth course along the narrow path between inflation and recession. Assuming brilliant monetary policy, the reduction in IOUs will require only the inconvenience of higher real interest rates, higher taxes of some form, a reduction of federal spending as a percentage of GNP, and slower economic growth. However, any miscalculation could trigger significant economic contraction.

The Third World

A hard core of third-world countries will remain even after the first world expands to include the newly industrialized countries. With possible exceptions such as Mexico, the third world is likely to remain outside first-world economic blocs, and intra-third-world efforts to form effective regional free trade associations likely will continue to be unsuccessful.

In the short run, the billions of dollars necessary for rebuilding Central and Eastern Europe will divert first world aid and private investment away from the third world. World real interest rates will rise in response to the large increase in demand for investment funds.

Reduced world military outlays will dampen the rise in rates, but even modestly higher interest rates will intensify third-world debt problems.

The third world can benefit from the ability of the United States to substitute economic aid for military aid as the threat of Marxist intervention subsides. Furthermore, emerging migration trends raise the very real concern that North America and Europe could be flooded with illegal immigration from a third world that is troubled by high birth rates, environmental neglect, economic degradation, and social unrest. The possibility of reducing this migration could motivate North to South aid. However, the U.S. budget deficit will limit any increase in overall U.S. assistance and part of existing aid will surely be channelled to Eastern Europe.

Higher interest rates and potentially less aid from other nations could cause hard-core third-world countries to confront and pursue internal policy reform. Much time and patience--internally and externally--will be required because policy changes and their results will come slowly. After reform, economic development must be largely of the third world's own doing rather than from a first-world fix.

With the switch from military to economic confrontation among the superpowers, spheres of economic influence likely will replace spheres of military influence as the focal point of international affairs. The American dollar will have to share world dominance with the D-mark zone of Europe (later the Euromark after the European Monetary Union) and the yen in East and Southeast Asia. A new mercantilist order could emerge if the superpowers do not make a firm and lasting commitment to freer trade. While a mercantilist system could retard third-world development, it could also awaken the third world to the potential for development from open world markets.

Underachieving Giants

An undiscussed issue is the role that second- and third-world giants like Brazil, India, China, and the Soviet Union will play in the emerging order. These countries possess the human and physical (natural and fixed capital) resources required for economic superpower status. Currently, however, each seems incapable of making the necessary institutional and policy adjustments needed for emergence to full economic strength.

Nuclear and conventional military capability, though diminished, will continue the Soviet Union's military superpower status but its economy will be especially difficult to revitalize. Even if it has a very real desire to join the "common European house," that desire will be thwarted by the absence of a tradition of democratic capitalism and its attendant market institutions and entrepreneurial skills. Radical economic reform can ultimately succeed, but the immediate sacrifice in consumer well-being may prove to be a very high price. The sad conclusion is that the foreseeable future holds economic malaise regardless of the choice of policy.

In contrast, China has strong entrepreneurial capabilities and an endemic work ethic, so the economy of a democratic-capitalist China would likely grow rapidly. The political-economic suppression imposed by the Marxist leaders on China (also, North Korea and

Cuba) is not sustainable in a world that is passing them by, but effective prediction of when changes will occur lies beyond our capability.

India, like China, has impressive entrepreneurial capabilities, and, unlike China, has successful institutions--including democracy. Like Brazil, however, India cannot seem to get its policies right for sustained growth. It must open its economy both internally and externally, a move that will be championed by a growing middle class.

In this hemisphere, Brazil could deliver on its promise to follow in the footsteps of the Asian NICs. In addition to agricultural exports, Brazil has major steel, auto, and shoe industries. An unprecedented attempt to break the yoke of the macroeconomic degradation process is now being played out. President Collar is showing unexpected resolve in moving this reborn democracy away from direct state ownership and control of the economy. An open economy, privatization, and sound macroeconomic policies could accelerate growth and food demand.

Implications for U.S. Agriculture

We realize that the subjects mentioned above deserve and are receiving book-length treatment by many capable scholars. The brief synopses of our best-guess scenarios, however, are deemed necessary to provide a basis on which to describe the implications for U.S. agriculture of this emerging economic order. We now turn to these implications.

* As production subsidies are withdrawn, farm and non-farm productivity in Central Europe will prove insufficient to support that region's current level

of consumption at free market prices. Moreover, the region's productivity is not adequate to earn the foreign exchange that is necessary for needed food imports. Central Europe will not be a significant *commercial* farm export market in the short run (up to five years), but concessional food exports to that region could be sizable.

* Over the longer run (ten years or more) restructuring Central Europe away from collective farming and central planning toward private farms will improve the productivity of its natural and human resources. Local supplies will not fill the demand for improved agricultural inputs. Significant potential will exist for exports to Central Europe of modern food processing technology and farm inputs such as pesticides. Improved processing technology and increased storage capacity will reduce post-harvest waste, further enhancing locally available food supplies.

* In the long run, as farm and nonfarm productivity improve, income and food consumption will rise in Central Europe. At present, despite large food subsidies, Central European countries (excluding East Germany and Czechoslovakia) have lower food consumption levels than countries in the EC that are at comparable latitudes. Diets include less livestock products and vegetable oils but more cereals. This mix will shift to more livestock and less cereal products as market determined prices and higher incomes become more important allocators.

* In the long run, Central Europe's increased demand for food products will be offset by increases in local supplies. No major change in overall Central European food self-sufficiency is expected except in grains where a surplus for export is expected. This conclusion assumes Central Europe will remain outside the Common Agricultural Policy of the EC. If Central Europe joins the EC and the Community continues its current level of farm subsidies, an even larger grain surplus can result.
* American agriculture has a big stake in turning the giant economic underachievers -- USSR, China, India, and Brazil -- into achievers. Under rapid economic growth food demand would outrun supply, especially in China and India. The result could be massive new U.S. farm export markets. Such prospects seem dim unless these countries can solve critical structural problems.
* Even with most-favored-nation status and the other trappings of full partnership in the world trading community, farm exports to the Soviet Union will remain variable but flat because of formidable foreign exchange constraints and other problems of a troubled Soviet economy.
* U.S. exports to hard-core third-world countries are likely to suffer mildly in the short run from higher interest rates and lower foreign aid. However, we view intermediate to long-term impacts of the new order as mostly positive both for U.S. agricultural exports and for third-world well-being. In the intermediate to long run, a larger first-world demand from the revitalized

countries of Central Europe and from competition for supremacy among the economic superpowers will expand demand for agricultural exports from the third world. Non-ag-related capital and technology will move to the third world to take advantage of low cost labor. The result will be expanded industrial output and exports. More exports will mean more foreign exchange to purchase U.S. farm commodities.

* The diverse wants of affluent nations will not be satisfied from domestic production, so the importance of international trade will be heightened. Self-sufficiency will not lose its allure, but pressures for economic progress and overall competitiveness will constrain the interventions that protect domestic agriculture. An economic alliance between any two of the three superpowers could win concessions from the third power. These factors will constrain the tendencies of economic superpowers towards neo-mercantilism. This should benefit U.S. agriculture.

* The world macroeconomy will rest more secure on three large, well-managed currency systems. European monetary union will bring Bundesbank-type monetary discipline and independence from political manipulation to nations in southern Europe never known for sound macroeconomic policies. The dollar will be relieved of some of its status as well as pressures that go with anchoring the world's economy. Given the unfortunate intrusions of unsound macroeconomic policies of the 1970s and 1980s, U.S. agriculture will welcome a period of world macroeconomic stability.

* Unlike the pattern of the 1980s, the United States will produce more than it consumes, lend more than it borrows, and export more than it imports. The many IOUs listed above will keep the dollar low. This is bad news for consumers but good news for producers. Because of its comparative advantage, agriculture will fare well. Wool, sugar, and manufactured dairy products in which the United States lacks comparative advantage will fare less well.
* The continuing pressure to meet social and infrastructure needs, maintain fiscal responsibility necessary to compete economically in the new international order, and retire the debt remaining from the 1980s will bring a careful re-examination of U.S. welfare programs. Expensive direct payment programs to farmers will not be sustainable. Food security will remain a concern but policies will attempt to stabilize food supplies at a lower real cost to taxpayers.
* Mandatory supply control commodity programs that insulate U.S. farmers from international markets seem out of the question because of the United States' need for competitiveness and foreign exchange.
* Pressure for international competitiveness means continuing emphasis on reducing U.S. farm production costs. This emphasis will be complicated by the rising real costs of labor and environmental compliance. Redirecting federal resources from paying farmers not to produce to paying for research, extension, and education that can provide safe and abundant food supplies in

the face of intense international competition and environmental constraints will make good sense.

Conclusions

Adaption of the U.S. economy in general, and its agriculture in particular, to the competitive new international order will entail sacrifice and opportunities. On the whole, however, a world driven more by economic competition and less by central planning will be better for U.S. agriculture as well as for consumers and producers worldwide. An enlarged world economy on the whole will be favorable for U.S. agriculture.

Despite this positive outlook, it is important to keep two caveats in mind: (1) The French revolution remains a sobering reminder that breaking up an old order, even in an atmosphere of good intentions and high ideals, can lead to violence and chaos. (2) Whatever the shortcomings of Soviet imperialism and the U.S.-Soviet balance of nuclear threats, the old order restrained the nationalist tendencies in Europe.

Withdrawal of Soviet control leaves a vacuum to be filled by unpredictable forces of nationalism in what is historically an unstable part of the world. Food assistance in the short run is one of the significant contributions the United States can make to the transformation of this part of the world.