AN AMERICAN VIEW ON THE EC-US CONFRONTATION*

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The most recent EC-US confrontation has occurred mainly as a result of the European Community's change from a net importer of cereal grain to a net exporter. Earlier confrontations were a by-product of EC-imposed trade restrictions (e.g., the so-called "chicken war") or grew out of efforts by the U.S. to gain concessions from the EC on agricultural products in return for U.S. trade concessions on industrial products. A new conflict threatens to emerge as a result of the EC's proposal to restrict imports of non-grain feed ingredients and to tax vegetable oils.

Increasing production above domestic requirements is the principal cause of the present conflict. The Community has found it expedient to dispose of surpluses by selling them on world markets. Initially the effects of EC agricultural support policies were mainly to displace imported commodities, but since the late 1970s, the EC has become a net exporter of grain. In theory, the consequences of encouraging domestic production are the same for exporters whether one reduces imports or increases exports, but export dumping is far more visible than import displacement and consequently leads to a somewhat stronger reaction.

The emergence of the European Community as a substantial exporter of wheat occurred at a time when the total world market for grain was no longer growing as rapidly as it had been during the mid 1970s. Unusually large crops in the United States in 1981 and 1982 compounded the problem. The U.S. found its market share declining owing to increased competition from other exporters, including the European Community, while its own

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surplus stocks were rising dramatically. This set the stage for the 1982 confrontation. The loss of markets was by no means solely a function of EC dumping surpluses, but such tactics were widely publicised and consequently EC agricultural policies became the target of widespread criticism in the United States. This reached a peak following the GATT meetings late in 1982. The unwillingness of EC, and especially France, to consider any policy changes or even to accept any responsibility for depressed world grain prices angered many members of the American delegation to the GATT meetings. What followed was predictable. Retaliatory measures against the European Community were demanded by those attending the GATT meetings. This ultimately led to subsidized sales of wheat flour to Egypt by the U.S. with the threat of further targeted subsidies to markets captured by the EC unless something was done to curb export dumping.

Since early in 1983, both sides have backed off from confrontation tactics and tensions appear to have eased. This can be attributed to policy changes, both in the EC and in the United States, and to fortuitous events, especially last year's drought which dramatically reduced feed grain production. The PIK program, reinforced by dry weather in the Midwest, eased the U.S. surplus problem and helped to strengthen world grain prices. As a result, there is now less pressure on the Secretary of Agriculture to retaliate against the European Community.

There have been significant policy changes on the other side of the Atlantic as well. In 1983, the EC agreed to restrict exports and to store additional quantities of grain. In 1984, they reduced very slightly the level of support prices. In addition, the community now appears willing to address the problem of surplus production, at least for milk. But the easing of tensions may be only temporary. If the EC restricts imports of corn gluten, or if the U.S. again finds surplus stocks rising and export sales declining, there will be renewed pressure on the Secretary of

Agriculture to take retaliatory action against the EC, regardless of which party occupies the White House or is in control of Congress.

The principal complaints of agricultural exporting nations against the EC are that the Community has maintained prices at levels which over-stimulate production, mainly of wheat, sugar, beef, broilers and milk, and that they behaved irresponsibly in dumping surpluses generated by overpricing. The United States, of course, is only one of many countries adversely affected by what the traditional exporters consider to be "unfair competition." The principle of supporting agriculture is not at issue since nearly all industrial countries maintain prices of at least some agricultural commodities above the level that would prevail in the absence of government intervention. It is the level of support and the way in which surpluses are handled that are the major causes of friction between the Community and the traditional exporters. EC support prices for grain, while below those of Switzerland, Norway and Japan, have averaged 50 percent or more above the support levels prevailing in the principal exporting countries, including the U.S., during the past decade (Roberts and Tie). In effect, traditional exporters have had to compete with the financial resources of the Community (limited only by the revenue collected from the value-added tax) rather than directly with farmers. Furthermore, the European Community has been less willing than the United States to store grain in order to avoid depressing world prices or to take action to curb domestic production.

Differences between the U.S. and EC support policies are less substantial for sugar than they are for cereals. Both support sugar at prices well above those prevailing on world markets; however, the EC competes more directly with traditional sugar exporters because it produces surpluses above domestic requirements while the U.S. does not.

The U.S. support program is less comprehensive for livestock products. Only milk among the major livestock products is supported in the United States, whereas beef, pork and poultry products as well as milk are supported in the Community. Margins above feed costs in the United States are dictated by market forces rather than support programs. In the case of dairy products, the margin of support in the EC appears to be slightly less than in the United States; however, there are more similarities than differences in the way in which surpluses have been handled. Both have accumulated large stocks of butter and skim milk powder and have dumped surpluses at various times on world markets at prices well below those maintained internally. Both are now seeking to restrain production, the EC by means of quotas, and the U.S. through a paid diversion program.

It must be conceded that the European Community has ample precedent for its policy of maintaining internal prices above those prevailing on world markets and disposing of surpluses by subsidizing exports. Many other industrial countries do likewise. Japan, for example, has subsidized rice exports in the past. Australia utilizes higher returns from domestic sales of grain to maintain average producer prices above those prevailing on world markets, while the U.S. now makes deficiency payments to producers whenever market prices fall below target prices. In the past, the U.S. has directly subsidized grain exports and now does so indirectly and in a modest way through various credit schemes. These facts are well known and consequently it is easy for EC officials to counter criticisms of the U.S. and other exporters by calling attention to our unclean hands.

The U.S. clearly is on weak ground in arguing against the principle of export subsidies. But that does not absolve the European Community. Some policies are more damaging to low-cost producers competing on world markets than others. EC export subsidies are more "unfair" to low-cost producers than are those of the United States because the level of support prevailing in the community is higher. Furthermore, the United States has at times helped to support world prices by its storage or reserve policies and by offering incentives for farmers to keep land idle.

The other argument of the EC in countering criticisms made by the United States is that the U.S. tends to ignore the benefits that have accrued to certain sub-sectors of American agriculture as a result of EC policies. While the U.S. has lost part of its market for corn and wheat as a result of such policies, it has benefited from increased sales of corn gluten, citrus pulp, soybeans and soybean meal. The EC is now trying to counter the effects of having created what amounts to a discriminatory pricing policy for feed ingredients. Apparently through oversight rather than design, non-cereal ingredients were not included in the items subject to variable levies when the EC Common Agricultural Policy was first formulated (Tangermann). Import duties on such items are relatively low. Furthermore, from the beginning, oilseeds and oilseed products have been permitted to come in duty free. As a result, EC feed manufacturers have had a strong incentive to substitute non-cereal ingredients and soybean meal for whole grain. Thailand, the United States and Brazil have been among the principal beneficiaries of increased sales of non-grain feed ingredients to the Community. Combined EC imports of all cereal substitutes nearly quadrupled between 1972 and 1982 (table 1.). During this same period, imports of soybeans and soybean meal approximately doubled. These imports have displaced grain that otherwise might have been used for animal feed, thus increasing the amount of surplus grain which must be exported. The availability of lower-cost feed ingredients also has added to the milk surplus problem by reducing the cost of feed and thus encouraging a higher rate of concentrate feeding to dairy cattle.

Table 1. EC Imports of Cereal Substitutes*

	1972	1982
	(mil. tons)	
Cassava	1.5	8.1
Bran	1.3	2.0
Corn gluten and distillers grain	.8	3.2
Citrus pulp	.2	1.3
All other cereal substitutes	.4	1.6
Total	4.2	16.2

*Based on 6 members in 1972 and 10 members in 1982.

In an attempt to plug this loophole, the Community has already negotiated voluntary restrictions with the principal suppliers of cassava chips and is now proposing to limit imports of other non-cereal ingredients. The Community also is proposing to compensate exporters of such products. Under GATT rules, this is required whenever restrictions that harm exporters are imposed. The objective of these measures is to halt further displacement of grain by non-cereal feed ingredients, thus reducing the need for export subsidies to dispose of surplus grain. Predictably, the U.S. has voiced strong opposition to the proposed restrictions, but if they were to be adopted, wheat exporters would gain since it would curb further displacement of cereals. Admittedly, the proposed change is inconsistent with the doctrine of free trade to which the current Administration has an ideological commitment, but it must be conceded that the U.S. has used similar tactics to protect its own car manufacturers and beef producers (i.e. by threatening to impose import quotas, it has persuaded exporters to restrict sales to the U.S. "voluntarily").

The U.S. wants the EC to continue permitting unlimited imports of corn gluten and soybeans, and at the same time restrict cereal exports. The EC would prefer to enter into market-sharing agreements that would enable them to maintain a significant volume of exports. In my view, neither side is being very realistic in maintaining their current positions. An effective market-sharing agreement on cereals would necessitate negotiating with a much larger group of nations than is the case with dairy products. The history of international commodity agreements does not offer much grounds for optimism on either the ability to negotiate a market-sharing agreement, or to enforce it even if successfully negotiated. It is equally unrealistic for the U.S. to expect the EC to maintain an open market for non-grain feed ingredients if surplus disposal costs continue to escalate.

The fundamental problem confronting both the U.S. and the European Community is excess productive capacity. Both are relying on exports to solve their surplus problem. Thus, I think it important that the fundamental causes of the confrontation be addressed. Both will be compelled by budgetary constraints to reduce the level of support for cereals, at least in real terms, but neither of the two protagonists is likely to cut support prices on grain by enough to avoid producing surpluses above the amount that can be sold at such prices, either at home or abroad. Thus, on both sides of the Atlantic, there will be pressure to adopt non-price mechanisms in an attempt to curb production. The EC has moved perceptibly in this direction by adopting a quota scheme for milk. Something similar may be done in an attempt to reduce the area planted to cereals if the cost of export restitution continues to mount. This would bring EC policies more in line with U.S. policies. At the same time, the U.S. is likely to be under strong pressure from Congress to offer greater subsidies to assist exports, especially if a strong dollar persists and U.S. exports remain stagnant or decline.

Thus, the U.S. may follow the lead of the Community in resorting to export subsidies (a move they would find difficult to oppose on ideological grounds), while the EC may be compelled (for budgetary reasons) to adopt measures similar to those which have been used in the U.S. to limit grain surpluses. Such a convergence of policies, while not consistent with free-market ideology, might help to ease tensions and reduce the possibility of an all-out trade war in which neither side would gain.

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