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# The 1985 FARM BILL: AN OVERVIEW OF TRADE OBJECTIVES

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## Introduction

The United States has a comparative advantage in agricultural production due to an abundance of fertile farmland, favorable climate, advanced technology and state-of-the-art infrastructure. This advantage has resulted in growing levels of agricultural exports which, along with sizable amounts of international food aid, provide a source of economic growth, foreign exchange, serve humanitarian needs, and promote a safer world in which to live.

In 1985, we again face the task of drafting new farm legislation to assist the agricultural sector in keeping agricultural demand in line with growing levels of productivity. To accomplish this, one requirement is that this legislation be designed to insure an expansion of overseas sales. In essence, the legislation must move toward a greater market orientation and allow prices to send signals to domestic producers and consumers concerning the production and consumption of food and fiber; and send signals to our competitors that we will no longer make unilateral adjustments in supply or provide a price umbrella for others to expand production and increase this market share at our expense.

Second, the legislation must provide an approach to exports that will reinforce our reputation as a reliable supplier by guaranteeing an open and fair trading system in which farmers will not be singled out and used as a instrument of foreign policy; and, encourage other nations to adopt an agricultural trading system in which commodities, including trade in high value products, can be conducted in an international atmosphere of free and fair trade.

To achieve these goals, the 1985 Farm Bill must chart a new course for U.S. agricultural policy, a path that is market-oriented yet provides a transition period for the farm sector. Basically such a policy would ebb and flow with the market, allowing adjustments in the farm sector to be made in response to market conditions. Such a policy would also challenge our competitors rather than encourage their expansion of production and trade.

## International Factors Affecting U.S. Agriculture

Many complex and highly interrelated factors influence the direction and magnitude of world trade in farm products. Unlike the period of the 1970's in which the rate of export growth was due in part to growth in the world economy, and a relatively low valued U.S. dollar, the 1980's have seen tight monetary policies, worldwide recession and a high valued dollar. These factors resulted in the United States experiencing a sharp drop in the value of agricultural exports to world markets after 1981. (Table 1).

A similar drop in export volume affected all major bulk commodities. (Table 2). The peak export tonnage for wheat and soybeans came in 1981/82, for rice a year earlier, and for cotton and corn even earlier in 1979/80.

Part of the explanation for the decline in U.S. farm exports is world economic trends but part of the explanation lies in the structure of U.S. farm programs, especially the relationship between support prices and market prices. With the exception of the early and late 1970's, market prices for wheat, rice and other major commodities have closely paralleled loan rates. In periods when market prices were well above loan rates, U.S. market percentage generally rose. In years when the loan rate was the major price determining factor, U.S. market percentages generally declined.

In the 1970s, with farm programs then in place, the United States was able to capitalize on the strong and expanding world market due to the large stocks, competitive prices and idle land that could be quickly brought into production to meet international market demands. But in the 1980s, this same set of policy instruments - the loan rate, the stocking program and the acreage reduction program - kept U.S. export prices higher than market clearing levels, and made the government the residual buyer, thus building large stocks and idling vast acres of cropland. At the same time competitors and customers alike were increasing acreage and production in response to the incentives of a world market price that was being supported by U.S. farm programs. In essence, U.S. farm programs of the past four years operated to force the United States to be the adjustor for the world market.

Wheat is a particular example. Over the past decade, production in several competing countries expanded by sizeable amounts (Table 3) and exports have also increased (Table 4). These trends became increasingly true after 1981 when higher support rates made the U.S. less competitive.

Besides U.S. farm programs, other factors such as LDC indebtedness and strengthening of the U.S. dollar have also been important in weakening U.S. farm trade volume. The impact of the strengthening dollar was particularly important in curtailing coarse grain and

soybean trade. A recent study published by the Economic Research Service[1/] indicates that exchange rates substantially reduced the volume of soybean trade, but that other factors masked the impact of a negative exchange rate. The key positive factor was a decline in foreign soybean production over the 2-year period (1981-1983) and a change in the internal pricing relationships within the European Economic Community that favored increased use of soybean meal. A decline in freight rates also helped because it tended to lower import prices for grains, oilseeds, and other products, thereby increasing foreign utilization.

Other conclusions concerning the eight demand factors considered (income and population growth, foreign crop production, USSR feeding/purchasing decisions, EC policy, foreign indebtedness, declining freight rates, and exchange rates) were:

- o No single factor was dominant across all commodities for the two year period studied.

- o While other factors reduced exports, declining freight rates had a surprisingly strong positive impact with additional exports of 1.3 million tons for wheat; 6.9 million tons for corn; and 0.4 million tons for soybeans.

- o The negative impact of the strengthening dollar was the most pronounced of the eight factors for coarse grains and soybeans/meal where, ceteris paribus, export volumes were 12.8 million tons and 3.3 million tons lower for the 2-year period, as a result of an approximate 30-percent real appreciation of the trade-weighted U.S. dollar.

- o The exchange rate impact for wheat (-3.8 million tons) ranked second, substantially behind the impact of larger foreign crop production in explaining the change in wheat exports.

## Economic Structure of Export Markets

While a multitude of factors influence the competitive position of the United States in international agricultural markets, a more fundamental issue is the basic economic structure of those markets. Depending on the structure of those markets, exports may or may not respond to different factors like changes in commodity prices. The foundation for a policy of agricultural export expansion rests on the belief that a set of export-oriented farm policies will restore export competitiveness for American agriculture and in turn, will allow the United States to expand exports, more fully use farm and agribusiness productive and marketing capacity, earn additional foreign exchange

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1/ Dunmore, John and James Longmire. Sources of Recent Changes in U.S. Agricultural Exports. IED/ERS/USDA. January 1984.

thus helping to offset the large trade deficit, and stabilize and increase U.S. producers incomes.

In general, current farm programs assume that the international demand for U.S. farm products is inelastic. This assumption has justified a system of high price supports and production controls. Very simply, if demand is inelastic, reduced output increases prices and leads to increased farm incomes.

This is the reason that "elasticity" -- the responsiveness of demand for U.S. farm products to changes in price -- is one of the key factors to be taken into consideration in developing farm programs. If farm programs are based on an incorrect assumption about the elasticity of demand, then they will cause farm incomes to decline whenever they attempt to make farm incomes rise.

The elasticity of foreign demand for U.S. farm products has been the subject of widespread research (for a comprehensive review of this research, see Robert L. Thompson, A Survey of Recent Developments in International Agricultural Trade Models, USDA/ERS, Bibliographies and Literature of Agriculture No. 21, September, 1981). Many analysts have undertaken the complicated steps necessary to make such estimates. G. Edward Schuh in his assessment argues that the price elasticity of demand is in the range of 2.0 to 3.0 ("U.S. Agricultural Policy in an Open World Economy", Testimony presented before the Joint Economic Committee of the U.S. Congress, May 26, 1983, Washington, D.C.). Professor Luther Tweeten in an earlier analysis calculated the long run aggregate elasticity of foreign demand for U.S. agricultural exports to be between 6.4 and 16 ("The Demand for U.S. Farm Output," Stanford University Food Research Institute Studies 7(1967): 343-369). Professor Paul Johnson calculated a value of 6.7 ("The Elasticity of Foreign Demand for U.S. Agricultural Products," American Journal of Agricultural Economics, 59(1977): 735-6), and Hoopen and Wilson estimate a value of 1.47 ("Two Multi-Level Models of U.S. Merchandise Trade,..." , Discussion Paper No. 47, Division of International Finance, Board of Governors of the Federal Reserve System, Washington, D.C., June, 1974).

In the case of U.S. wheat exports (excluding PL-480), recent USDA investigations indicate a long term elasticity of foreign demand with respect to the U.S. loan rate of 1.70. These investigations indicate that this result is highly statistically significant and show that we can be 66 percent sure that the elasticity is between 1.47 and 1.93 and that we can be 95 percent sure that the elasticity is between 1.25 and 2.15. In otherwords, there is extremely strong evidence to indicate that foreign demand for U.S. wheat is elastic in the longer term. In a market where demand is elastic, a fall in price will increase sales value, since the increase in quantity shipped will more than offset the decrease in price.

If the elasticity of foreign demand is in the neighborhood of 1.70, as shown in these investigations, then a 10 percent real reduction in the loan rate would increase wheat exports by 17 percent

over about a 3 year period. This means that such a reduction would increase wheat exports by about 6.5 million metric tons after most major adjustments have taken place. It would also increase wheat farmers' incomes by about $235 million, or about $525 per wheat farmer.

Most important, although these investigations indicate that foreign demand is elastic with respect to both prices and the U.S. loan rate, they show conclusively that the single most significant explanation for fluctuations in foreign demand for U.S. wheat is fluctuations in the level of the U.S. wheat loan rate.

Of course, a reduction in the loan rate is not the same thing as a reduction in prices. Prices could continue to fluctuate at or above the loan rate. However, the reduced loan rate would remove the price certainty that currently exists for producers in competitor countries and improve our competitive position in foreign markets.

## LDC Debt and Food Demand

Another major factor influencing U.S. farm exports since 1981 has been the weak demand from the LDC countries. At the end of 1984, many developing countries, especially in Africa and Latin America, were still struggling with debt, domestic economic crises, and relatively weak trade and financial trends.

Worldwide, economic growth rates increased substantially in 1984 from the sluggish pace of 1983. Growth in the U.S. economy outstripped the rate of other industrialized countries again in 1984, but by a somewhat smaller margin. Economic growth rates in Latin America, Africa, and the Middle East still lag other regions of the world, but a turnaround from last year's negative growth rates was achieved. Overall, the world economic growth rate was forecast to reach 4 percent in 1984, about double the year earlier rate.

Although economic growth has improved, some weakness persists. Unemployment rates in many European countries continued to increase in 1984, despite the broadening recovery. In addition, foreign exchange shortages in many regions, particularly developing countries, continued. Problems of these countries will continue to preoccupy policymakers in the field of trade and finance.

During the 1970s, many developing countries experienced rapid economic growth. With rapidly expanding export and domestic markets, oil price increases spurring the search for new energy supplies, and the overall need to finance higher domestic investment and import levels, many developing countries provided very attractive lending opportunities to international capital markets. The recycling of petro dollars by the commercial banks at close to zero and sometimes even negative real rates of interest -- is a well-known story.

After the turn of the decade, however, the situation in many developing countries deteriorated and by 1982, recession virtually

covered the Third World. Those developing countries which were successful in rescheduling external debts began to recover in 1984 while others sank further into crisis. Among the latter, there are few prospects for any quick return to earlier growth trends.

What turned a difficult situation into a crisis for many of the middle-income developing countries, in the early 1980s, was a withdrawal of major commercial banks from further lending. Without a continuing source of foreign capital, many of these heavily-indebted countries were unable to service their debt fully and on a timely basis. Most also had to curtail imports.

Decreases in agricultural imports were major contributors to the decrease in the total imports of the high debt LDCs. For example, total U.S. agricultural exports to 17 major debt countries dropped 20 percent ($1.3 billion), between 1981 and 1983, while total U.S. exports to these countries went down 40 percent ($16 billion). Thus the decline in agricultural imports has been less in percentage terms than the decline in other categories of imports. Declines in grain and oilseed exports accounted for a large proportion of the decline in U.S. agricultural exports to the major debt countries.

## Trade Policy Practices

To keep U.S. exports growing, access to foreign markets for U.S. agricultural products is essential. Access is ofttimes restricted, and U.S. exporters often face competion aided by subsidies from competitor governments.

In developed countries examples of import restrictions are the importation of grains handled by government agencies or marketing boards, the use of import quotas and/or licensing as for beef and oranges in Japan, and the use of variable levies in Europe, to protect against imports that are priced below internal price guarantees.

Developing countries, also tend to have restrictive import regimes enforced by import licensing or in the case of basic food crops often directly controlled by state agencies. A few developing countries that can afford to, provide incentives to agricultural exports as a means of earning foreign exchange. Other developing countries use direct export payments or provide credit for their products. Some LDCs have sought to gain advantages through overvalued exchange rate, state trading arrangements, counter-trade deals, and export tax incentives.

The United States is the world's largest agricultural exporter, and a nation that depends on export markets for sales of two-thirds of its wheat crop, half its soybean crop, and 40 percent of its rice and cotton crops. It is essential that we continue to oppose strongly the restrictive and unfair trading practices of other countries.

Of particular concern are the subsidy practices of the European Community which result in losses of markets for U.S. exporters. These practices must be changed if the economic base of U.S. agriculture is to be strengthened. This requires a long-term commitment by the United States to seek changes in the GATT Subsidies Code that will bring about an elimination of export subsidies on primary products.

Such a commitment must be steady and uncompromising. Essentially, the EC and other nations must be persuaded to move toward a market-determined international trading system and away from a government interventionist system. The United States itself can usefully lead the way by moving away from protectionist policies for its own agricultural sector.

## Food Assistance

The United States is the largest source of international food aid. Since 1954, P.L. 480 has shipped over 33 billion dollars of U.S. farm commodities to other countries. The United States is also a major source of food security for the world, partly because our storage programs permit us to respond to both emergency and non-emergency needs. And we have the largest program of technical assistance. Although often overlooked, the use of foreign currency funds generated by the sale of P.L. 480 commodities sometimes represents the largest source of U.S. funding for programs to improve domestic agriculture in recipient countries. Overall, U.S. agricultural programs including P.L. 480 make important contributions to agricultural development in the poorest countries.

In the last decade food aid, has declined as a proportion of U.S. agricultural exports. As a share of our commercial exports, food aid averaged 4.5 percent during 1974-83, a much lower percentage than during the 1960s; in 1984, the share was about 4 percent. The shrinking relative importance of food aid to our exports was due in large part to the rapid growth of commercial exports.

The magnitude and nature of LDC imports over the next several years will continue to be influenced by indigenous production and the ability to import commodities on a commercial basis. High population growth will continue to inhibit expansion of per capita production in many LDCs to little above the recent levels. In addition, income growth for these countries has slowed because import demands by developed countries for products of the LDCs have decreased and international credits are not available in sufficient amounts to facilitate servicing of past debt or supporting continued expansion of many of these economies. This slower growth has weakened the ability of the LDCs to import commercially.

LDC food deficits vary with definition. USDA's annual report on World Food Aid Needs and Availabilities, (July, 1984) covers 67 food aid recipient countries and estimates 1984/85 food imports under two

conditions -- Status quo and Nutrition-based. Status quo estimates are based on per capita consumption equal to the four-year, 1980 to 1984 averages. Nutrition-based is based on per capita consumption equal to minimum dietary standards established by FAO and WHO.

Estimates of status quo food import needs for FANA countries in 1984/85 are 31 million tons of which 12 million tons of food aid will be required. Nutrition-based food import needs are somewhat higher, at 47 million tons, with food aid needs of 26 million tons. U.S. shipments in 1984/85 under Titles I/II are estimated at 6.0 million tons; other countries ship additional amounts.

There are currently those who would increase U.S. food aid shipments. As an extreme case, an increase in U.S. food aid to a mid-1960s share of U.S. commercial agricultural exports would require 6 billion dollars. This would represent a 15 percent increase in total exports of U.S. farm products. It would be difficult to ensure that such an increase would be additional, because there probably would be some substitution of new food aid for commercial sales and the substitution rate would increase as the level of food aid increases. Furthermore, the United States would be increasingly open to criticism from other exporters that we are displacing their sales. In addition, the food aid character of such exports could be sharply eroded by the surplus disposal character, which was prevalent in the 1950s and 1960s. From a development viewpoint, such massive increase in food aid might discourage the trend toward market-oriented agricultural policies and self sufficiency in recipient countries.

Opportunities do, however, exist for a more modest increase in food aid. Recent declines in per capita food production in a significant number of LDCs, particularly in Africa, have increased food aid needs. Further, the external debt burdens of a growing number of LDCs and resultant decreases in foreign exchange availabilities for commercial food imports also increases food aid requirements.

## Summary

Agricultural exports have become a major source of demand for American farm output. Farm export volume increased from 38 million tons in 1970 to 144 million tons in FY 1984. Even the 1984 tonnage was below the high achieved in 1980 when the U.S. shipped nearly 164 million tons of agricultural commodities to overseas markets.

The 20 million tons drop in farm exports between 1980 and 1984 brought with it a corresponding drop in farm income and rural asset values, and an increase in the costs of Government farm programs. This should not be surprising since under the current structure of farm programs, the Federal government stands ready to be a "market of last resort." This includes storage programs and land retirement

programs that act as a shock absorber and protect the farm sector against a drop in world demand and an increase in exports from other countries.

The reality that U.S. farm exports have dropped so substantially and the corresponding increase in exports from other supplying countries is only part of the argument for making major changes in the structure of U.S. farm programs in 1985. A more basic factor that favors this change is the recent analytical work that indicates that international markets for U.S. agricultural commodities are "price-responsive". These studies suggest that both buyers of agricultural commodities and producers of agricultural commodities in other countries are responsive over a period of time to changes in the prices they pay or receive for farm commodities. Buyers would purchase more at lower prices and other producers would produce less over a period of years if the guarantees provided by U.S. support programs are lowered.

Given that the latest analytical work indicates a long run "elastic" market exists for U.S. farm exports, policies like those implemented in the recent past will work against the economic interests of American agriculture. The first evidence of this appeared after 1981, when U.S. farm exports started to decline and other supplying countries started to increase acreages and exports. These trends, if continued, will result in the idlying of an ever larger amount of U.S. agricultural productive capacity. On the other hand, a restructuring of farm policies to take advantage of the more elastic foreign demand for farm products can result in a slow recovery of export markets for U.S. agriculture and an improvement in farm incomes and asset values, not to mention the positive effects on the agribusiness sector and the strengthening of the rural banking community.

Basically, the Congress and the Administration face the task in 1985 of turning farm programs in a direction that will take advantage of the only market with any significant expansion potential -- the export market. Legislation must facilitate an expansion of farm exports if the agricultural sector is to benefit in the longer term. This task begins with restructuring support prices so that U.S. farm commodities can compete on world markets against sales from other countries, thus putting pressure on those countries to slow the growth in their own production and exports. Of course, there must be some amount of economic "safety net" provided to U.S. farmers during the interim period while they regain some portion of the export market which has been lost since 1980.

Beyond these changes in basic commodity programs, there will continue to be a strong need for adequate export credit programs to tide the LDCs over the interim period until economic growth reestablishes their capacity to import farm products by selling more of their own products overseas. There are also other legislative changes that can facilitate more farm exports, including strengthening

our food aid programs, strengthening embargo protection for farmers, eliminating cargo preference requirements, and strengthening our commercial export credit programs. But none of these steps can be entirely effective unless we are able to reestablish ourselves as price-competitive in world markets. That is the first priority.

Table 1: U.S. AGRICULTURAL TRADE STATISTICS

| Marketing Year | Exports | | Imports | | Trade Balance |
|---|---|---|---|---|---|
| | Value | Volume | Value | Volume | |
| | ($Mil.) | (MMT) | ($Mil.) | (MMT) | ($Mil.) |
| 1970 | 6,958 | 61.8 | 5,686 | - | + 1,272 |
| 1971 | 7,955 | 63.3 | 6,128 | - | + 1,827 |
| 1972 | 8,242 | 68.6 | 5,936 | - | + 2,306 |
| 1973 | 14,984 | 106.6 | 7,737 | - | + 7,247 |
| 1974 | 21,559 | 99.9 | 10,031 | - | + 11,528 |
| 1975 | 21,817 | 93.5 | 9,435 | - | + 12,382 |
| 1976 | 22,742 | 114.1 | 10,497 | 11.2 | + 12,250 |
| 1977 | 23,974 | 111.9 | 13,357 | 11.4 | + 10,617 |
| 1978 | 27,289 | 131.3 | 13,886 | 11.3 | + 13,403 |
| 1979 | 31,979 | 137.4 | 16,186 | 11.5 | + 15,793 |
| 1980 | 40,481 | 163.9 | 17,276 | 10.7 | + 23,205 |
| 1981 | 43,780 | 162.3 | 17,218 | 10.8 | + 26,562 |
| 1982 | 39,095 | 157.9 | 15,489 | 10.5 | + 23,606 |
| 1983 | 34,776 | 144.8 | 16,375 | 9.8 | + 18,401 |
| 1984 | 38,013 | 143.7 | 18,910 | 10.0 | + 19,103 |

Table 2: U.S. AGRICULTURAL EXPORT VOLUME FOR SELECTED COMMODITIES

| FISCAL YEAR | WHEAT | CORN | RICE | SOYBEANS | COTTON |
|---|---|---|---|---|---|
| | | --Million Metric Tons-- | | | |
| 1969/70 | 15.688 | 15.150 | 1.775 | 12.222 | .643 |
| 1970/71 | 18.227 | 12.736 | 1.621 | 11.787 | .957 |
| 1971/72 | 17.070 | 19.939 | 1.868 | 10.957 | .692 |
| 1972/73 | 35.867 | 31.544 | 1.675 | 12.843 | 1.326 |
| 1973/74 | 26.756 | 31.006 | 1.696 | 15.092 | 1.318 |
| 1974/75 | 29.272 | 28.822 | 2.217 | 11.487 | .892 |
| 1975/76 | 29.874 | 43.126 | 1.953 | 15.050 | .782 |
| 1976/77 | 23.766 | 42.454 | 2.317 | 15.156 | 1.046 |
| 1977/78 | 31.813 | 49.112 | 2.276 | 19.686 | 1.378 |
| 1978/79 | 31.340 | 53.897 | 2.397 | 20.194 | 1.396 |
| 1979/80 | 36.066 | 61.417 | 2.955 | 23.833 | 2.047 |
| 1980/81 | 42.247 | 59.367 | 3.172 | 19.972 | 1.264 |
| 1981/82 | 44.609 | 49.608 | 2.911 | 25.477 | 1.556 |
| 1982/83 | 36.699 | 47.105 | 2.276 | 24.522 | 1.209 |
| 1983/84 | 41.700 | 47.001 | 2.293 | 19.198 | 1.498 |

Table 3. WHEAT AREA HARVESTED IN U.S. AND COMPETITOR COUNTRIES, 1970 TO 1983.

| Year | United States | Total Competitor | EC | Canada | Australia | Argentina |
|---|---|---|---|---|---|---|
| | | | (million hectares) | | | |
| 1970 | 17.6 | 26.1 | 10.9 | 5.1 | 6.4 | 3.7 |
| 1975 | 28.1 | 34.8 | 11.4 | 9.5 | 8.6 | 5.3 |
| 1980 | 28.8 | 40.4 | 12.6 | 11.1 | 11.3 | 5.0 |
| 1981 | 32.6 | 42.8 | 12.6 | 12.4 | 11.9 | 5.9 |
| 1982 | 31.5 | 44.4 | 13.0 | 12.6 | 11.5 | 7.3 |
| 1983 | 24.8 | 46.7 | 13.2 | 13.7 | 12.9 | 6.9 |
| 1984 | 27.2 | 45.1 | 13.6 | 13.2 | 12.3 | 6.0 |

Table 4. EXPORTS OF WHEAT FROM THE U.S. AND COMPETITOR COUNTRIES 1970/71 to 1983/84.

| Year | United States | Total Competitor | EC | Canada | Australia | Argentina |
|---|---|---|---|---|---|---|
| | | | (million metric tons) | | | |
| 1970-71 | 19.8 | 27.5 | 5.7 | 11.8 | 9.1 | 0.9 |
| 1975-76 | 31.9 | 32.8 | 8.6 | 12.3 | 8.7 | 3.2 |
| 1980-81 | 41.2 | 44.4 | 14.7 | 16.3 | 9.6 | 3.8 |
| 1981-82 | 48.2 | 48.6 | 15.5 | 18.4 | 11.1 | 3.6 |
| 1982-83 | 41.1 | 54.1 | 15.5 | 21.4 | 7.3 | 9.9 |
| 1983-84 | 38.9 | 59.1 | 16.0 | 21.8 | 13.5 | 7.8 |
| 1984-85 | 41.5 | 56.4 | 18.5 | 16.7 | 15.0 | 6.2 |