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INTERNATIONAL TRADE AS A SOURCE OF RISK AND UNCERTAINTY

John Dunmore

International trade has become a very important element in the overall equation for vitality in the U.S. farm sector. The list of indicators that can be gleaned from current literature detailing the importance of trade to the U.S. farm and nonfarm sectors and of the increased linkage of the agricultural sector to U.S. and world macroeconomic conditions has grown in number and in frequency of usage. The litany of indicators include:

- 1) Agriculture and kindred activities account for about 20 percent of GNP;
- 2) Agriculture and kindred activities employ over 20 percent of the labor force;
- 3) Production of nearly 2 out of every 5 acres goes to the export market;
- 4) Each U.S. farmer produces enough food for 78 people, 21 of whom live abroad;
- 5) The downturn in global economic conditions and the high value of the dollar have reduced U.S. agricultural commodity exports.

This paper addresses another generalization about U.S. agriculture and its "internationalized" environment -- "instability in world agriculture markets is generating increased risk and uncertainty in the U.S. farm sector." A primary source of the variability in the prices received for grain products by U.S. farmers is the volatility of world markets. The uncertainty stemming from this variability affects farmers' investment and production decisions and in turn the whole U.S. agricultural sector. The importance of dealing with this price risk and uncertainty at the farm level cannot be overemphasized.

Coping with instability is a major issue facing farm managers. Dealing with instability from a public program/policy standpoint is a major issue facing policymakers as well. This paper addresses three major sources of instability emanating from the world market:

- 1) Increased production variability and the instability inherent in the structure of world commodity markets;
- 2) Macroeconomic and financial variability; and
- 3) Agricultural and trade policy uncertainties.

The paper concludes with a few options for dealing with the increased uncertainty in world agricultural markets.

DOMESTIC PRICE VARIABILITY

U.S. commodity markets were fairly stable during the 1950s and 1960s. Year-to-year changes in prices tended to be relatively small. Several factors accounted for this stability. First, the U.S. agricultural sector was less dependent on foreign markets, and hence changes in the international economy had relatively limited effects on the domestic agriculture sector. Second, domestic commodity programs and large government reserves helped to stabilize domestic and world market prices. In addition, as Schuh points out, monetary policy during the period was also relatively stable (6).

The world market became unusually volatile during the 1970s and early 1980s. Results from a study by O'Brien of USDA's Economic Research Service found swings in a weighted index of real prices of farm products moving on the world market have been as wide as +/- 20 to 30 percent in less than a year (1972/73, 1974/75, and 1977/78), and have set record real highs and lows in less than 2 years. Individual product prices were even more volatile (4).

Increased price variability was a major factor behind the noticeable variability in net farm income. After remaining relatively stable through the 1950s and 1960s, net farm income gyrated wildly in the 1970s and early 1980s. The variability of net farm income was about four times greater in the 1970s and early 1980s than in the 1950s.

This increased instability emanating from world markets has a number of explanations. These factors include:

- 1) Increased trade among countries with variable production;
- 2) Growing imperfections in the structure and performance of world commodity markets;
- 3) Changing macroeconomic environment that now allows world economic conditions to more directly effect the U.S. farm sector; and
- 4) Use of farm and trade policies by both grain importing and exporting countries which a) insulate themselves from world market variability, and/or b) shift the impact of domestic crop production variability into the world market.

Production Variability and Imperfections in World Commodity Markets

A review of the characteristics of selected world commodity markets from a structure, conduct, and performance standpoint concludes that many of these markets fall short of meeting conditions of perfectly competitive markets. Indeed, one could conclude that instability is now an inherent quality characteristic of several world commodity markets.

Thinness of the Market -- From a structural standpoint, world commodity markets are often characterized as "thin" -- relating to the relatively small portion of world production and consumption which flows through commodity markets. The portion of world grain production entering trade has been increasing as importers become more dependent on trade to meet domestic consumption requirements. But, world grain trade still is only 18 percent of world grain production. For sugar, the portion rises to nearly one-third but for other commodities the proportion is much lower -- beef, 7.5 percent; and rice, one-half of 1 percent. Kelly White, also of the Economic Research Service, points out that such thinness could allow major producers or consumers to have substantial impact on world markets (9). For example, a 10 percent change in U.S. soybean production is equivalent to about a 20 percent change in world soybean trade. And a 10 percent change in Chinese rice production is equivalent to a 100 percent change in world rice trade.

Variability in farm output at the world level appears to have changed little, with ups and downs in one country offsetting changes elsewhere. But increased year-to-year variations in many individual countries have been marked. While difficult to measure precisely, this increase in year-to-year swings in farm output appears to relate in some cases to agriculture's expansion into marginal areas more sensitive to swings in weather or possibly to a more fundamental change in climate. In more than a few countries, increasingly unstable agricultural production is related to changes in government policies affecting price supports, input subsidizations, commodity procurement, and marketing (4). Many of the countries with the most pronounced increases in volatility tend to be key trading countries or regions with a disproportionately large impact on the world market. When these major producing or consuming countries elect to transmit the burden of a supply or demand shock onto the world market rather than absorbing the variability domestically, wide fluctuations in prices may occur.

Degree of Market Concentration -- A related structural characteristic is the degree of concentration in world commodity markets. According to the Food and Agriculture Organization over 200 countries participated in world food trade in 1982. In addition, the number of countries regularly importing more than 1 million tons of food is up from six or seven in 1934-38 to over 40 in

1980 (4). However, despite the large number of countries participating in world markets and the increase in the number of "large" importers (1 million tons or more), the bulk of world grain and oilseed trade takes place between a small handful of countries. For example:

- 0 94 percent of wheat exports accounted for by the top five exporters;
- 0 93 percent of world corn exports accounted for by the top five exporters;
- 0 95 percent of soybean exports accounted for by the top three exporters;
- 0 56 percent of wheat imports accounted for by the top seven importers;
- 0 50 percent of corn imports accounted for by the top six importers;
- 0 60 percent of soybean imports accounted for by the top two importers.

A country's dependence on trade is a major determinant of the responsiveness of import demand to movements in world prices (3). Most importing countries are generally only marginal importers of farm products -- import only a small portion of total food consumed. The more dependent a country becomes on imports to meet consumption, Japan for example, the less responsive imports will be to movements in the world price. Over the decade of the 1970s, the dependence of the major grain importers (as a group) on trade to satisfy domestic consumption needs has increased. The self-sufficiency ratio (production/consumption) for major importers declined from 90 percent in 1969-71 to 81 percent in 1979-81 (2). This increased dependence on trade likely worked to reduce the level of importer responsiveness to movements in price -- a world market characterized by increasingly inelastic import demand elasticities. Particularly for wheat, low prices generate only limited increases in demand while high prices generate only limited decreases in demand. As pointed out by O'Brien, in many of the largest wheat importing countries, the level of imports is more a function of food and trade policies than economics (4).

Another structural characteristic which indicates a relatively high degree of concentration is the number of decision-makers involved in the operation of world markets. In most LDCs (Lesser Developed Countries) and all centrally-planned economies, trade is conducted directly by the government or government-sanctioned monopolies. In many of the developed countries, trade is conducted through marketing boards or state trading institutions such as the Food Agency in Japan which regulates all imports of wheat. Even in the United States where trade is largely private, the four largest firms handle the bulk of U.S. grain exports. Thus, the number of actors involved in day-to-day decision-making in world commodity markets is relatively small.

Market Insulation -- A related characteristic dealing as much with the conduct of world commodity markets as with its structure, is the tendency for many countries to insulate their producers and consumers from

world commodity market shocks and fluctuations. Many countries achieve domestic market stability through domestic market insulation. While there is considerable evidence that producers and consumers are generally responsive to domestic price movements, insulating policies cause the price signals emanating from the world market to be relatively weak (3).

With respect to domestic farm policies, changes in consumer-oriented or producer-oriented food policies can have a very direct impact on the sensitivity of the supply-demand response to economic variables (prices and incomes). Consumer-oriented policies tend to encourage artificially high levels of consumption by supplementing the normal income/demand relationships by changing effective income or prices. For example, food subsidies in many centrally planned and developing countries allow food consumption and food imports at a higher level than if consumers faced the generally higher world market prices. The consumer subsidy on bread in Egypt, for example, has led to large imports of wheat and wheat flour. A recent study from Egypt, the second largest wheat importer in the developing world, indicates that commercial wheat imports would be eliminated if wheat prices to producers and consumers reflected world prices. On the producer side, many countries have domestic policies which provide supports above world market price and/or provide subsidies on inputs to lower unit production costs -- the aim being increased levels of food production and less dependence on imports (self-sufficiency). Under these types of domestic farm policies, neither producers nor consumers receive the necessary signals to alter their production or consumption in line with changed world market conditions, and the burden of adjustment is shifted to those countries, and the portions of trade, which do respond to world price signals.

It has long been recognized that non-tariff trade restrictions, such as quantitative controls and variable levies, cut the link between the world market price and the domestic price. The variable levy system of the European Community for grains, and the fixed resale price for wheat in Japan are examples of this type of break in world/domestic price linkages. Also, the state trading nature of countries in the centrally planned (and much of the LDC) regions present another obvious break between world price movements and domestic prices. Consider the case of wheat. The bulk of wheat purchased in 1980 went to state traders: only about 3 percent of the wheat imported in 1980 was purchased by free trading countries, while 84 percent was imported by countries with central purchasing agents (state traders). In other words, for wheat, countries representing only about 3 percent of world imports were freely taking part in the adjustment process from the importer side.

As trade restrictions and market insulation practices increase, the level of price transmission declines. The impact is to

lower the overall trade response of foreign exporters and/or importers to movements in world prices (3). The increasing price variability over the decade of the 1970s is an indication that the ability of the world market to perform its function of balancing supply and demand with minimum price disruption has been severely impaired.

These market insulation policies force the burden of adjustment to those countries, such as the United States, whose policies and programs are more closely tied to the world market. Whether or not one agrees that the U.S. is a residual supplier in world markets, the United States has become the residual adjuster in world markets. This has led to some concern that the U.S. farm sector will continue to bear the burden of increased instability in U.S. commodity markets as our participation in world markets continues.

Increased U.S. Market Share -- Fundamental changes in the structure, conduct, and performance characteristics of the world grain market (market concentration and market insulation) have resulted in a lessened response of foreign import demand to movement in world prices over time. As the U.S. share of world grain trade increased during the 1970s, the ability of individual countries to obtain a larger share of import supplies from alternative sources lessened. In conjunction with the changes in market structure, this lessening availability of alternative supplies caused the price responsiveness, or the elasticity of demand, for the exports of the U.S. to fall over time. Over the 1960s and 1970s, the U.S. share of world grain trade increased -- the net availability of alternative supplies as a portion of foreign importer requirements has declined, thereby lowering the price elasticity of foreign demand for U.S. farm products.

In summary, the change in the structure of selected world commodity markets, particularly grains; the increased insulation and weakened response of importers to changes in the world prices; and the increasing role of the U.S. in world grain markets over the 1970s served to make U.S. commodity markets unusually volatile. A given change in foreign demand for U.S. commodities was associated with an increasingly greater change in price -- the price elasticity of foreign demand for U.S. farm exports was declining over the decade of the 1970s.

International Macroeconomic Variability and Uncertainty

There has been a growing sensitivity of U.S. agricultural exports to broader macroeconomic trends and policy developments. This heightened sensitivity was evident over the 1970s and early 1980s, with a change in U.S. monetary policy and the international value of the dollar. U.S. monetary policy was relatively stable over most of the 1950s and 1960s and the changes in monetary policy that did take place tended to have relatively little impact on agriculture. Conditions changed dramatically in the 1970s.

Macroeconomic policies, particularly monetary policy, became less stable as the Federal Reserve actively intervened to accelerate or to slow down economic activity and inflation by placing added controls on growth in the money supply and by influencing interest rates (4, 6). At the same time, agriculture's increasing dependence on exports combined with the emergence of a well integrated international capital market, and a shift to a system of flexible exchange rates made the U.S. farm sector far more sensitive to changes in macroeconomic policies than at any other time in the past.

Given the tighter linkages between U.S. and world macroeconomic and financial conditions, the United States becomes not only a victim of, but a contributor to, increased volatility and uncertainty in world agricultural commodity markets. The United States has contributed to uncertainty through macroeconomic policies which have caused fluctuations in exchange rates, interest rates, and economic growth rates around the world.

Two recent macroeconomic phenomena: the rise in the value of the dollar, and the international financial/debt crisis have particularly important implications for volatility and uncertainty in U.S. markets.

Rise in the Value of the Dollar -- Exchange rate movements have been an important consequence of shifts in macroeconomic policy over the past three years. The U.S. dollar has strengthened considerably against most of the major traded currencies -- by as much as 50 to 60 percent in nominal terms. This sharp appreciation of the U.S. dollar measured in both nominal and real terms has made U.S. farm exports more expensive than products available from other suppliers. The first-round impacts of the dollar appreciation are clear. First, a stronger dollar increases the foreign currency cost of imported food and feed products, reducing the import demand and putting further downward pressure on prices. In addition, U.S. products become more expensive relative to exports from competing suppliers whose currencies are depreciating against the dollar.

A second round, but no less important impact of a stronger dollar, combined with rising U.S. commodity support levels, has been the sharp rise in export returns enjoyed by other major traders since 1981. Given the role the U.S. dollar price plays in setting the world price, and because much of world trade in farm products is denominated in dollars, an appreciating dollar tends to raise other exporters' local currency trade prices automatically. In response, the major foreign competitors have increased their farm output and marketed more aggressively over the last few years to take advantage of these substantially higher returns. This production/export response to the stronger dollar has implications not only for the current marketing year, but for the next several years as the competitors' additional production leads to increased export supply availabilities. Recent analyses completed by

the Economic Research Service indicate that a 10 percent change in the value of the U.S. dollar will lead over a 3-5 year period to roughly an 8 percent change in the volume of trade and 10-11 percent change in the value of U.S. agricultural exports (3).

Besides adding to the variability of growth in foreign demand for U.S. farm products, the appreciation of the U.S. dollar has a distinct impact on the uncertainty associated with trade. The changing value of the dollar has introduced additional variability in international exchange markets, and therefore has increased the risk to traders in international transactions. Many of the commodity traders in the international marketplace are now as much concerned with hedging the risk surrounding the movements of exchange rates as they are in movements in farm prices.

Financial Instability -- It is impossible to discuss risk and uncertainty in the context of international commodity markets without realizing the significant impact imposed by the short-term liquidity crises -- exacerbated by the rising debt burdens of developing countries. Happily, signs of increased cooperation among the debtor and developed nations are already appearing and it now seems likely that large-scale financial dislocations or even defaults by some of these countries will be avoided.

The special financial problems of the debtor nations can impact the variability and uncertainty in international commodity markets in two major ways. First, constraints on availability and use of foreign exchange can severely alter the trading patterns of the impacted developing countries. Such a change in trading patterns for major developing markets, such as Mexico and Brazil, can add to instability in international commodity markets. Second, given the level of debt repayment capacity of several countries and the increased costs of new capital and additional debt service, the level of risk and uncertainty for any given commodity trader or financial institution in dealing with those countries is substantially heightened.

With foreign exchange reserves gradually eroding, the choice available to developing countries is a hard one: restrict the availability of foreign exchange (dollars) to importers, thereby cutting imports. As a result of deteriorating financial conditions, many developing countries have been forced to take drastic steps to improve their trade balances. Import limiting instruments including tariffs, mandatory import licenses, and bans or suspensions on the importation of specific products have been put into effect in several debt-prone countries. Exporting nations also are being pressured to maintain and/or increase exports in order to generate needed foreign exchange. Use of price discounting, subsidies, and other means for expanding exports (often in a declining market) have become all the more frequent.

It is difficult to quantify the likely impact of these changes in trade policies. However, the notion that importers and

exporters are turning more and more to the world market for solutions to worsening problems is quite clear. What is also clear is that these policies lead to a more unstable world commodity market. There will be no short-term, quick-fix solutions to the international debt problem for many developing countries. The consensus of many who have been monitoring and studying the international debt issue is that it will take a 3-5 year period for most developing countries to realign their balance of payments and financial conditions to the point where they can return to their historical growth paths (7). For some countries, the adjustment period will be shorter (1-2 years) while for others the adjustment process could take more than 5 years. There is a possible perversity in terms of the consequence for U.S. agricultural trade concerning the rapidity with which developing countries make the adjustments to bring their balance of payments and financial structure into order. A gradual adjustment period of up to 5 years would likely mean continued slow growth or perhaps no growth in U.S. agricultural exports to the affected developing countries. On the other hand, an adjustment period of 1 to 2 years would require extremely austere monetary and fiscal adjustments which would mean further cuts in import capacity and a likely decline in U.S. agricultural exports. So, the shorter the time frame for the adjustment, the deeper could be the impact on U.S. farm trade over the next few years. Of course, following the shorter adjustment period, a country would return all the sooner to a stronger growth path and U.S. farm trade could improve accordingly.

Farm and Trade Policies

From a trade policy perspective, there are essentially no totally free trading countries in the world. All countries have policies that in some way restrict or discourage certain imports and underwrite or subsidize certain exports. Differences among countries are matters of degree, although some of these differences are large and significant.

What course countries take in the next few years with regard to their agricultural and trade policies will have a major impact on commodity trade. Several countries in Eastern Europe and the middle-income developing countries have already begun to reverse long-standing food consumption subsidy programs. In Brazil and Mexico, compliance with the required International Monetary Fund (IMF) austerity program meant a reduction or elimination of many production and consumption subsidies. Domestic consumption and import demand for some products has been restricted in these countries, adding to the variability in U.S. farm exports.

With respect to the consumer and producer-oriented policies discussed earlier, there are at present budget and financial difficulties in developed as well as developing countries, and there is every likelihood that these financial problems will

continue at least through the mid-to-late 1980s. The question is asked: Can countries continue to support producers and/or consumers at the levels of the late 1970s and early 1980s? Or will some retrenchment be likely in the next few years? Decisions in these areas impact not only on potential variability in world trade but on uncertainty with respect to longer-term growth prospects for world and U.S. farm trade.

History has shown that when economic and financial times are tough, countries look with increasing interest to the international market for relief from problems generated internally. During times such as these, protectionism and unfair trade practices increase. The U.S., as well as other major exporters, is not immune to this temptation. The increased use of protectionist and unfair trade practices simply adds to world market instability. Moreover, O'Brien suggests that modification in farm and trade policies in attempts to ease domestic problems could lead to a confrontation among major traders -- a confrontation that would result in not only a weakened but a terribly unstable world commodity market environment (4).

Policies followed by the United States have also contributed to the loss in U.S. market share (5). During the late 1970s, prices in the United States were generally between the target price and the loan rate. Since farmers receive a deficiency payment, there is an incentive to increase production, unless land must be idled to receive the payment. Market prices are free to allocate supply and demand, and with additional supply due to the deficiency payment, prices to domestic and foreign consumers must fall to increase the quantity demanded. In this manner, domestic and export use is implicitly subsidized by a target price policy, and exports increase. In the late 1970s, when land retirement programs were not in effect, U.S. commodity programs implicitly subsidized U.S. exports and encouraged the U.S. to expand its market share.

Increased U.S. production and the decline in world import demand in the early 1980s resulted in U.S. prices falling to the loan rate. When U.S. loan rates are set above the market-clearing level of world prices, U.S. exports are priced higher than they would be otherwise and foreign producers are put in a better position to undercut the U.S. price in world markets. The U.S. loan rate acts as a price floor which raises the world price. Importing nations buy less because of the higher price. Thus, the U.S. loan rate operates like an export tax. Farmers in other exporting countries respond to the higher price by increasing production. These nations do not absorb the additional production by holding stocks, but instead export it at a price just below the U.S. price umbrella. The result is that the United States loses market share to other exporting nations.

For most years between 1950 and 1973, U.S. loan rates supported world prices. To remain competitive, the United States paid direct export subsidies on wheat until 1973. With

recent declines in U.S. prices to loan levels, which are above market-clearing levels, U.S. policy is again implicitly taxing exports. Thus, part of the recent loss in the U.S. market share could be attributed to U.S. policy, which sometimes implicitly subsidized U.S. exports, giving the U.S. a larger share, and sometimes implicitly taxed them, resulting in a fall in the U.S. market share.

Other sources of volatility in international commodity markets with regard to agricultural and trade policies are episodic trade policy and political events. While it is clear that embargoes, such as the soybean embargo of 1973, or the partial and full embargoes on agricultural product sales to the Soviet Union led to more volatile price environments during those periods of time, it is less clear that non-agricultural trade issues also add an element of instability to world commodity markets. In today's trade and trade policy environment, agricultural and non-agricultural markets are interlinked. There are costs, in terms of potential loss of agricultural export sales, associated with increased restrictions on imports of steel, copper, or cotton textiles on the part of the United States. While it is difficult to measure the exact instability or uncertainty associated with such episodic trade policy decision, it is probably safe to assume that such decisions do not add to stability of world markets.

In summarizing the sources of risk and instability associated with the international market environment, world commodity markets can be classified as typically thin, volatile, and subject to the vagaries of international politics and macroeconomic relationships. And, while increasing dependence on foreign markets for U.S. farm products has contributed to growth in the farm sector in the 1970s, it has also contributed to the increased instability of domestic agricultural markets. U.S. producers and consumers have absorbed most of the cost of the resulting variability.

U.S. agriculture will remain heavily involved in world markets, however. Substantial withdrawal to domestic markets is unrealistic. Instability is the price we must pay to trade in world markets. We must be prepared to deal with internal implications with intelligent policies at the national and international levels, and well thought-out methods for dealing with risk and instability at the farm management and farm marketing level.

TRADE PROGRAM/POLICY ISSUES

The course of commodity policy in the United States continues to play a dominant role in determining the efficiency with which world commodity markets function. However, the internationalization of U.S. agriculture has exposed U.S. farmers to new sources of instability that cannot be solved by domestic farm programs alone. There are agricultural trade policy initiatives as well as domestic initiatives that could be pursued to improve the performance of world markets and help to

reduce the risk and uncertainty faced by U.S. producers.

Ultimately, commodity markets will become more stable only as international trade becomes freer and markets become more open. Instability is as much a problem of trade policy as of stocks policy, and the long-term "optimal" solution, therefore, has to be sought in part in improved trade policy. However, in the shorter term, and realizing the probabilities associated with achieving the "optimal" solution, we, as economists, may have to look for sub-optimum, second-best solutions. The following is a list of agricultural trade proposals that are being widely discussed -- all of which fall generally in the areas of foreign demand enhancement and market stabilization.

Bilateral Agreements. There are some who suggest that the United States should strive for more bilateral agreements to insure our share of world markets. The Canadians and Australians generally have one-half to two-thirds of their grain trade under such agreements. And from an importer perspective, many large grain importers such as the Soviet Union and China insist on such agreements. While bilateral agreements are not in the interest of free trade, and recognizing that excessive use may lead to increased world market price instability, bilateral agreements have to be considered in the context of the realities of the marketplace. Others argue that the U.S. should consider bilateral agreements in limited situations but at the same time encourage the importers to expand grain storage and rely less on the world market to absorb domestic production variability. Sharples and Goodloe point out that the trade agreement between the United States and the Soviet Union with upper and lower bounds on trade volume is a step in that direction (8).

Multilateral Cooperation. The United States does not favor the use of international agreements to stabilize markets or to expand sales. Buffer stock schemes with a set of high and low price bands are often difficult to administer. The price band should reflect long-term market trends in prices. But, to the extent they do not, the market is restricted to some degree from performing its resource-adjusting function. In addition, agreement by exporters on specified stockholding levels to some degree restricts the world market function of "market-rationing" among exporters. In other words, it may not allow exporters to take full advantage of changing competitive positions.

Recall the attempted establishment of a new international wheat agreement in 1979. Participating countries generally agreed to the notion of an internationally coordinated system of nationally held reserve stocks to be accumulated when prices were low and released when prices were high. However, the participants could not agree on the trigger price levels for release or buying of stocks, the size of aggregate stocks and of individual countries' shares, or the concessions and assistance to apply to developing countries.

Several analysts contend that the price support and reserve programs of the United States, in the absence of an international agreement to coordinate national storage policies, have forced the United States to play a residual adjuster role. The United States absorbs much of the volume adjustments to trade that are transmitted to the world by other countries through build ups or draw downs in U.S. grain stocks. Thus, the United States, many argue, has essentially underwritten the cost to other countries (importers and exporters) of participating in a more volatile world market. The costs associated with the increased residual adjuster role played by the United States has been high, leading to the payment-in-kind (PIK) program in 1983.

Some analysts argue that the mix of political and institutional factors at play in world commodity markets has altered market realities. Further, the changed market environment -- now characterized by low prices, high stock levels, debt-plagued developing countries, and the outlook for a slowly growing but increasingly volatile world market -- suggests a potentially more cooperative environment. In such an environment, progress might be made toward developing a coordinated stock-holding policy among exporters, a policy designed to more equitably share the burden of adjustment and to further common market stabilization goals.

Export Credits/Food Assistance. Many importing countries are currently confronted with extraordinary debt burdens. The short-term liquidity problems in international capital markets severely restrict their ability to import. Many argue that increased authority for the USDA-GSM-102 Export Credit Guarantee and various P.L. 480 programs will provide the incentive to maintain and increase import financing. They contend that making credit and/or food aid available will permit the import of food into these countries and, in addition, will have a positive effect by bridging the foreign exchange gap, allowing for non-food imports vital to economic recovery. The U.S. trade deficit problem will be aided through larger exports of both food and non-food products, and through greater economic growth in importing countries. Given the financial situation that many developing and middle income countries find themselves in, it seems that this will be another issue that will receive much attention in the near future.

More Effective International Institutions. There is increasing concern about the effectiveness of the General Agreement on Tariffs and Trade (GATT) as a forum for settling international trade disputes, particularly in the agricultural area. While negotiations have been successful in reducing barriers to trade in manufactured products, little progress has been made in reducing trade barriers to agricultural products. As Schuh points out, an important reason why it has been so difficult to negotiate reductions in agricultural trade barriers is that to do so would require negotiations over domestic

programs and policies to which the particular trade barriers and interventions are tied (6). Nevertheless, it is expected that the next round of multilateral trade negotiations will, in fact, tackle the issue of reducing agricultural trade barriers and limiting the use of export subsidies.

Another problem with the structure of the GATT is that the countries which have been the fastest growing in agricultural trade, such as the developing countries and the centrally planned economies, are not members of the GATT and are, therefore, not committed to abide by the rules established under GATT. Thus, there is a belief by many that GATT must be made more effective and responsive if freer world trade is ever to be achieved.

TRADE AND POLICY LINKAGES

Events of recent years have heightened our awareness of the linkages between policy decisions and the competitive position of the United States in world commodity markets (1). These linkages are of three types: farm policy, fiscal and monetary policy, and trade policy. The subject of farm trade and policy linkages is complicated and cannot be treated in detail here. There are, however, a few essential points with regard to agriculture's stake in these linkages that bear highlighting.

Farm Policy Consistency

U.S. farm policies will continue to have a big effect on exports. The critical concern is ensuring that domestic farm programs do not undermine the U.S. competitive position in world markets. There is strong evidence that the rigid commodity programs in place over the past 3 years served to weaken U.S. competitiveness. In an increasingly volatile and competitive market, U.S. domestic farm programs have to be flexible and responsive to unpredictable market developments. What is important if we are to be efficient and competitive is that U.S. programs not insulate farmers from realities of the market place. Any industry that remains healthy over the long run must be responsive to the forces of supply and demand. As we move toward developing a 1985 Farm Bill, an understanding by all parties involved of this key linkage between domestic farm policy and trade will be critical to the debate.

Fiscal and Monetary Policies Consistent with Trade Objectives

It has already been demonstrated that farmers' well-being is affected as much today by budget deficits, interest rates, money supplies and other aspects of our general economic policy as by traditional farm programs. Management of economic policy is difficult in an open economy where domestic policy actions have international consequences that ultimately feed back, in sometimes perverse ways, into the domestic economy. With regard to the long-run health of the agricultural economy, appropriate monetary and

fiscal policies are probably as important as the 1985 Farm Bill itself. Agricultural interests need to be more involved with debates on general economic policy such as those on the deficit.

National Trade Policy Must be Consistent and Enlightened

To be effective and credible in our efforts to promote a freer agricultural world market, our trade policies must be consistent across all sectors of the economy. We must acknowledge and make progress toward eliminating our own restrictions on food and fiber imports. In other words, we cannot be free traders for one product or industry and protectionist for others. The adage, "if we want to sell, we must be prepared to buy," becomes all the more appropriate. Farmers and agricultural interest groups do have a stake in so-called "domestic content" legislation and in other attempts to avoid competitive forces rather than adjust to them. The pressure to erect trade barriers will remain strong during these early stages of recovery. Farm groups and organizations must continue to seek an improved understanding of these national trade policy/agricultural trade linkages to assure that actions taken are in their enlightened self interest.

CONCLUSION

The United States has little choice but to expand its involvement in world agricultural markets. But those markets offer difficult challenges. The setting is one of increasing volatility and great uncertainty. Widening swings in foreign production, combined with a poorly performing world market, have more than doubled year-to-year swings in U.S. exports. Changing trade policies and international financial and macroeconomic developments have also become considerably more subject to change. The impact of these changes on world import demand is a growing source of uncertainty for an export-oriented U.S. agriculture. Progress can be made in this setting. The problem of international risk and uncertainty might be addressed by any one, or combination of the foreign demand enhancement and stabilization measures currently being discussed. But doing so requires, in addition, enlightened and consistent economic, trade and farm policies which are necessary to realize the substantial potential benefits from the continued

dependence of the U.S. agricultural sector on foreign markets.

John Dunmore is Acting Associate Administrator, Economic Research Service, USDA.

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