

SEEKING AGRICULTURAL COMPETITIVENESS THROUGH TRADE NEGOTIATIONS: WANTING DOESN'T MAKE IT SO

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In September, 1986, the United States joined the 92 members of the General Agreement on Tariffs and Trade (commonly referred to as the GATT) in launching the eighth round of multilateral trade negotiations. (Formerly, agriculture has been off to the side of the GATT negotiations.) With agricultural trade tensions at a post war high, a number of GATT member governments want agriculture fast, front and center.

Negotiations: Critical and Next to Impossible

But wanting doesn't make it so. Despite the desires of the United States and other countries to deal with agriculture in this round of talks, U.S. agriculture finds itself in a position where international negotiations are all but critical and next to impossible.

Negotiations are crucial because over the past fifteen years the fortunes of U.S. agriculture have become inextricably linked to the international market. At the height of the export boom, two out of every five acres in the United States were planted for export, exports generated more than 30 percent of U.S. agriculture's cash receipts, and U.S. agriculture prospered. The sharp decline in exports since 1981 has thrown U.S. agriculture into a tailspin. Agriculture's problems have their root in the international economy, and the solutions must be sought there.

But, prevailing conditions make international negotiations in the GATT next to impossible. Agricultural surpluses are at historical highs and are likely to continue increasing. Demand for agricultural imports is sluggish. Exporting countries have been forced into subsidizing exports to defend old and acquire new markets. Domestic agricultural policies and problems are spilling over into the international economy, wreaking havoc with international trading relations. The situation calls for talking in organizations like the GATT through

the next round of multilateral trade negotiations, but everyone seems to be yelling about unfair trade practices and predatory policies.

GATT: The Only Negotiating Forum

Before going further it is perhaps useful to explain the GATT—a mystery wrapped in an enigma even to those who know it well. The GATT is an interim committee to an organization that does not exist. That organization—the International Trade Organization (ITO)—was proposed by the United States at the time of the Bretton Woods accords. It was to be the third leg of the international organizational stool—the International Monetary Fund (IMF) for finance; the World Bank for development and the International Trade Organization for trade. The ITO was to promote trade liberalization and expansion and to police market arrangements. Congress, unwilling to relinquish power over domestic policy to an international organization, vetoed the ITO. The General Agreement on Tariffs and Trade, then, grew out of the remains of the ITO. It expresses the sentiments of trade liberalization, but provides for an ineffective dispute settlement procedure without enforcement powers. However, for all its warts, the GATT is the only multilateral trade organization we have and its rules are respected, if not in the observance then in the breach.

The original drafters of the GATT did not exclude or exempt agriculture from trade liberalization. But the United States, by virtue of being the largest agricultural producer and the most politically powerful member of the GATT, was able to obtain the now infamous Section 22 waiver. The Section 22 waiver allows the United States to set import quotas if imports threaten the government's ability to carry out certain domestic commodity programs (such as the dairy and sugar programs). The United States was also instrumental in excluding agriculture from rules prohibiting export subsidies.

In the post World War II period, when the United States sought these exceptions and exclusions, and even though U.S. trade policies were hostile to the spirit of the GATT and required special treatment, they did not impose heavy costs on other countries and thus did not incense our trading partners.

Surplus Disposal Policies Do Not Work Well

In the 1950s and 1960s, U.S. agriculture was characterized by surpluses, low prices and significant acreage reduction programs. The United States disposed of those surpluses onto the world market through the Food for Peace program (PL-480) and through export subsidies.

During the 1950s and 1960s these policies worked reasonably well. In those years exports accounted for a relatively small proportion of U.S. agricultural production, but relative to world trade, U.S. exports were quite large. The United States had few competitors who could meet or beat our prices—subsidized or not. At that time Europe was recovering from the war and was not self-sufficient in agricultural products. The continent provided an important market for subsidized U.S. grain. Few developing countries produced wheat and feed grains in sufficient quantities for export and a number relied on PL-480 shipments.

The present situation of U.S. agriculture is, in some ways, quite similar to that of the late 1950s and the 1960s. U.S. domestic policies have encouraged the accumulation of huge surpluses, the 1985 Food Security Act calls for low prices and drastic acreage reduction programs.

But the situation is also quite different primarily because the world is different. U.S. agriculture depends much more heavily on the export market than it did in the 1950s and 1960s. And that export market is no longer ours to dominate. Technology flows more rapidly across national borders and productive capacity and competition are increasing. A number of countries have joined the United States as major exporters and their agricultural policies are important to the United States.

Agriculture is also more integrated into the general domestic economy. The sector's dependence on capital investment and purchased inputs and services make inflation and interest rates important. Agriculture is also more integrated into the international economy through its dependence on trade. Thus, exchange rates, international capital flows, foreign countries' agricultural policies, and worldwide economic growth will now determine agriculture's fortunes.

Low prices and subsidies will not buy back U.S. prosperity. The export enhancement program and marketing loans might have worked well in the 1950s and 1960s but they will fail miserably in the 1980s. In fact, they are likely to incite a trade riot.

1970s Export Boom Not Likely to Repeat

The United States can no longer afford to take comfort in those GATT exclusions and exceptions it negotiated after the war. The conditions that fueled the export boom of the 1970s will not likely be repeated; the United States is no longer the dominant exporting country; and domestic agricultural policies impose huge costs across borders. Without negotiations, the current agricultural crisis could deteriorate into an agricultural cataclysm.

The export boom that began in 1973 was precipitated by a confluence of circumstances that are not likely to be repeated. Between 1940 and 1972, U.S. exports rose steadily, increasing at an annual rate of \$400 million (in 1985 dollars), based on growth in population and per capita income. Then in 1973, policy changes abroad and in the United States fueled export growth and sent shock waves through U.S. agriculture's export markets that would reverberate throughout the decade. That year, U.S. exports jumped \$5.7 billion (in 1985 dollars) and continued to increase through 1981 at five times the historical rate (Rossmiller 1986a).

The Soviet Union decided to buy grain on the world market, increasing U.S. exports by 8 million metric tons in one year alone. More important for the longer term was OPEC's quadrupling of the price of oil, leading to a tremendous increase in petrodollars and international liquidity.

Those petrodollars were transferred from developed countries to developing countries, recycled through the international banking system. Developing countries were encouraged by low real interest rates to borrow from the banks. Commercial bank lending to the developing countries increased approximately 20 percent annually throughout much of the decade. The borrowed capital allowed developing countries to more than proportionately increase their imports from the United States over the decade.

The United States made some policy changes that affected agriculture as well. In 1973 the United States had decided it would no longer be the world's macroeconomic thermostat and suspended the convertibility of the dollar. With the move from fixed to floating exchange rates, the value of the dollar fell and import prices began to fluctuate with the changing relative prices of international monies.

The United States, like other developed countries, responded to the OPEC price increase by inflating its economy, leading to low interest rates, high inflation and high growth. High rates of economic growth contributed to the export boom. Annual growth rates of 3.5 percent in the developed countries, 3 percent in the centrally planned economies and over 6 percent in the developing economies increased demand for agricultural products (Executive Office of the President, p. 378).

The United States, being the residual supplier in the world market, benefited most from these salubrious conditions. With a cheap dollar, competitive prices, large tracts of land in acreage reduction programs and huge stocks, the United States could respond more rapidly than its competitors to the increase in demand for agricultural products.

With the export boom, low interest rates and high inflation, land values soared. Between 1977 and 1981 the value of farm real estate

rose 31 percent across the country (U.S. Department of Agriculture 1985, p. 6). On the strength of an economic anomaly, bankers lent and farmers borrowed against their land to invest in more land and machinery. And farmers increased their production to fill what everyone predicted would be an ever growing world demand.

With between 40 and 60 percent of corn and wheat farmer's cash receipts coming from exports, many farmers depended heavily on those exports to repay their loans (Sanderson). But unfortunately the conditions that fed the boom no longer existed by the first half of the 1980s.

Between 1960 and 1985, worldwide agricultural production of the major food and feedgrains (wheat, rice and coarse grains) almost doubled, from 846 million metric tons to 1,642 million metric tons. Over that same period, the volume of world grain trade has expanded two and a half times, from 72 million metric tons to 180 million metric tons (Rossmiller et al 1986, p. 79).

Over those years, a number of countries joined the United States as agricultural exporters. For example, in 1960 the European Community (EC) and India were net wheat importers; by 1985, both were net exporters. Argentina increased its wheat exports from almost nothing in 1960 to 9.4 million metric tons in 1984. Over that same period, Canada's wheat exports doubled and Australia's exports almost tripled. A similar story can be told for soybeans, corn and other commodities. There are a number of other competitors out there in the 1980s vying for markets the United States called its own in the 1950s, '60s and '70s.

In late 1981 the macroeconomic conditions that had thrust U.S. exports upwards reversed to send exports into a sharp decline. When OPEC again upped the price of oil, the United States faced unacceptable double-digit inflation. The Federal Reserve responded with a contractionary monetary policy designed to wring inflation out of the economy. At the same time, the U.S. administration and Congress began to run an expansionary fiscal policy. This combination raised interest rates and attracted foreign capital to the United States. Consequently, between 1980 and 1985, the value of the dollar rose by 60 percent against the currencies of U.S. trading partners, making U.S. agricultural exports expensive.

The high interest rates and consequent overvalued dollar hindered U.S. exports more through their impact on the international economy than through their impact on agricultural prices per se. The contractionary monetary policies of the United States (and other developed countries which were forced to follow suit) provoked a recession that dampened demand worldwide.

High interest rates and expensive dollars damaged the economies of developing countries which had incurred dollar denominated debt

with floating interest rates in the '70s. By 1982 the 21 major developing and Eastern Bloc debtors faced a total debt of about \$450 billion and net interest payments of \$42 billion. Many countries were forced to reschedule their debts and undergo IMF austerity programs. Under those programs countries were required to reduce their imports. After making their payments they had little foreign exchange left over to buy U.S. wheat and corn. For example, Mexico, after increasing its imports from the United States by 35 percent between 1980 and 1981, decreased its imports by 45 percent in 1982, the first year of the debt crisis. Similarly, Brazil's imports rose 19 percent between 1980 and 1981, then fell 31 percent the following year (Rossmiller and Tutwiler 1986a). As the economic reversal took hold, U.S. agricultural exports dropped by \$4.7 billion in 1982 and have continued down through the 1986 estimates at an annual rate of \$1.6 billion (Rossmiller 1986a, pp. 24-25).

U.S. agricultural policy in the early 1980s did not help matters. The 1981 farm bill incorporated a schedule of increasing support prices predicated on expectations of double-digit inflation. While double-digit inflation did not materialize, increases in support prices did. When combined with the high dollar, U.S. policies priced U.S. agriculture out of the world market.

At the same time these policies hurt U.S. exports, they helped our competitors. High U.S. prices encouraged countries like Argentina and Brazil to expand their exports. High U.S. prices and the dollar lowered Europe's restitution costs and probably allowed them to export more than they might have otherwise. U.S. exports of wheat fell 9.3 million metric tons between 1981 and 1984 while its competitors' exports increased by 10.5 million metric tons. Half of those exports came from developed country competition; half from Argentina (Rossmiller and Tutwiler 1986b, p. 4). Playing the unenviable role of the residual adjustor in a declining market, the United States could not adjust quickly to the downturn in demand and lost market share.

Macroeconomy Will Not Bail Out U.S. Agriculture

The macroeconomic and agricultural crises have fundamentally altered the economic and policy environment. Unfortunately, as we go into the next GATT round, the macroeconomy and agricultural policy are still reeling from the changes. And in some cases not enough has changed and some of the changes have done more harm than good.

Since central bankers from France, Germany, Japan, the United Kingdom and the United States (the Group of Five) met in New York City in November, 1985, the United States and other developed countries have moved to push the dollar down. The fall in the dollar will boost exports, but not as much as some would hope.

While the impact of the overvalued dollar on agricultural exports in the early 1980s was important, its effect varied and was often exaggerated. For example, the price of U.S. soybeans in terms of European currencies rose 70 percent. However the price of wheat and corn were unaffected by the value of the dollar because for these commodities the European Community fixes domestic agricultural prices using the variable levy system of the Common Agricultural Policy. The price of soybeans to Japan rose 25 percent, while the price of U.S. commodities to many developing countries did not change at all because their exchange rates are tied to the dollar (Sanderson, p. 4).

Similarly, expectations that the drop in the value of the dollar will be the panacea to boost exports are ill-founded. While the value of the dollar has fallen 30 percent on average, it has not fallen against the currencies of some of our major competitors or of our major importers. As is widely publicized, from its March 1985 peak, the dollar has depreciated most against the European currencies—approximately 30 percent. But from its average 1984 value (a better estimate of the dollar's true price in the first half of the decade) the U.S. dollar has actually risen 6.4 percent against the Canadian dollar and is also up against the Mexican peso by 20 percent. The U.S. dollar is also higher, in real terms, against the currencies of South Korea, Taiwan, Hong Kong, Brazil, Australia and Argentina. While the lower dollar is bound to help agricultural exports, it will not do so quickly (Rossmiller and Tutwiler 1986b, p. 5).

Much of the dollar's decline has been induced by a fall in U.S. interest rates. Lower interest rates will help agriculture on two fronts. Domestically, lower interest rates will—eventually—translate into lower debt payments for farmers. (Although this effect may be delayed since banks are somewhat skittish about lending money to agriculture at present.) Lower interest rates will also mean lower debt payments for developing countries which should free up some exchange for increased agricultural imports.

But, even with lower payments, U.S. farmers and debtor countries are still staggering under huge debt burdens. As of January, 1985, farm debt totaled \$212 billion, with 17 percent of farmers considered to be in severe financial stress (U.S. Department of Agriculture 1985, p. 18). In 1984 (the latest year for which figures are available) developing country debt totaled between \$812 and \$843 billion, equal to about one third of their GNP (Executive Office of the President, U.S. Trade Representative, p. 12). The former are still financially stressed and the latter are unable to substantially boost their imports from the United States.

In addition to a cheaper dollar and lower interest rates, U.S. agricultural policy has substantially decreased support prices. While the 1985 Food Security Act represents no wholesale changes in U.S. farm

policy, it does retool some of those policies in an attempt to make U.S. products more competitive on the world market. Loan rates have been lowered dramatically and future loan rates will be determined according to competitive demands in the world markets, rather than by a purely domestic formula. The farm bill also lowers export prices through export credits and marketing loans.

These lower prices will translate into increased exports, but not before the next election. Unwilling to wait, impatient policymakers and politicians have negotiated subsidized sales of wheat to the Soviets and sugar to the Chinese in an effort to increase exports more immediately. While these sales may give exports a visible and sudden boost, they have been met with hostility by our competitors.

There is evidence to suggest that in the short run—and perhaps even in the long run—our competitors will follow U.S. prices downward, taking most of the punch out of lower U.S. prices. This past spring the National Center for Food and Agricultural Policy was involved in a project to evaluate how U.S. competitors would respond to export subsidies and lower prices (Rossmiller 1986b). Government officials in Argentina, Brazil, Australia, Canada and the European Community confirmed that they will meet U.S. prices, passively or aggressively.

In the short run, Argentina will export regardless of the international price because of inadequate storage capacity. Over the longer term, Argentina will export because the country needs foreign exchange to repay its international debt. Argentina's recent moves to lower agricultural export taxes and to devalue its currency indicate a willingness to change policy to maintain agricultural exports. And, to the extent that the country can reduce taxes further and improve agricultural infrastructure, Argentina can follow U.S. prices down quite far. In April, 1986, when U.S. farmers received \$90 per metric ton of corn, Argentine farmers received \$36 per metric ton.

Brazil has been increasing soybean production and crushing capacity since the late 1970s and can now produce soybean oil in excess of domestic requirements. While Brazil consumes about 90 percent of the soy oil produced, it consumes about 25 percent of the soymeal by-product. Brazilian export policy is dominated by concern over domestic vegetable oil prices. So, in the short term, Brazil will export excess supplies of soy oil and soy meal regardless of the international price. In the longer term, Brazilian soybean production would be expected to decline to the point at which only enough oil is produced for domestic consumption. Excess soymeal would continue to be exported. Resources shifted out of soybean production would most likely move into the production of foodstuffs such as fruit that are currently imported.

In the past, when world prices were low, Australia held stocks in an attempt to boost prices. But during the 1980s, the Australian Wheat Board was compelled to alter its method of operation with significant implications for the country's international market behavior. Forced by the thinness of Australian capital markets to finance its operations in the international capital market, the Australian Wheat Board quickly came to appreciate the time value of money and the high costs of stock holding. When the Australian drought significantly reduced exports in 1980, and Australia saw no discernable effect on world prices, the board reasoned the reverse would hold and Australia became a non price-responsive seller. So, in the short term Australia will not reduce its exports in response to lower U.S. prices. In the longer term, lower world prices would likely cause exports and production to shrink. But production alternatives in Australia are limited to sheep and wheat so production adjustments would occur mainly through reduced fertilizer and pesticide applications.

In the late 1970s, Canada made significant investments in west coast port capacity and rail transport in order to expand exports. Also, to stress their commitment as a reliable supplier, the Canadian Wheat Board has negotiated long-term supply agreements covering 80 to 90 percent of Canada's wheat export sales. The Canadians have both a commitment and an obligation to maintain exports. The Canadian reaction to the lower loan rates in the 1985 Food Security Act is instructive: the Wheat Board lowered initial prices by 19 percent for 1986 and planting intentions rose, however slightly. In the longer term, lower loan rates and lower world prices will diminish farm income. Should the Canadian government choose to support farm income, exports will not drop and could increase. Should the government choose not to support farm incomes, land values could be expected to deflate, lowering production costs and maintaining Canadian competitiveness. Finally, the Canadian Wheat Board is completely flexible on individual sales, and is therefore capable of meeting U.S. prices market by market.

The EC is also unlikely to be undersold. It can set export restitutions quickly and easily, market by market, to remain competitive. And rhetoric aside, there is no budget constraint on the Community when it comes to keeping its export markets. Europe sees the lower loan rates and the targeted export programs as predatory and will raise revenue through supplemental appropriations if necessary to counter what they consider to be aggressive U.S. policies. So, even though the cheaper dollar and the lower loan rates have raised the cost of the EC's export restitutions, the Community stands ready to match U.S. prices.

In the next few months these subsidized sales will cause exports to blip upward, but over the next year our competitors will meet or beat U.S. prices to maintain or increase their own exports. However, the fact remains that subsidies—whoever pays them—will not solve the

problem as long as there is too much grain in the world and too few buyers.

Wheat and coarse grain supplies are expected to exceed 1.6 billion tons, 25 percent more than world demand and nearly double the amount that supply has usually exceeded demand. Ending stocks in the United States for 1985-86 are estimated to account for 95 percent of total wheat demand, and 50 percent of corn demand (U.S. Department of Agriculture 1986).

And there is little to suggest that they will diminish in the medium to longer term. A recent report by the Office of Technology Assessment predicts that new technologies will boost the annual rate of growth in milk production from 2.6 percent to 3.9 percent by 2000 (U.S. Congress). Increases in crop production will not be as dramatic, but corn yields could increase from 113 bushels per acre in 1982 to as much as 150 bushels per acre by the year 2000. Similarly, wheat yields are predicted to rise from 36 bushels per acre to 45 bushels. And this is just in the United States. With the recent performance of India and China as examples, there is little reason to doubt that a number of developing countries will be able to significantly expand their production.

If a glut is to be avoided, demand must increase. But the prospects for growth high enough to solve the problem are dim. Growth in the United States and other developed countries has been sluggish. The drop in the value of the dollar has damaged the Japanese economy and is hurting the exporting sectors of the European economy. And while the lower dollar bodes well for debt burdened less developed countries, it could harm those who rely on exports. Fears of rekindling an inflation that is seemingly slumbering in the wake of recent cuts in the discount rate will probably prevent governments from aggressively pursuing growth regardless of the effect on prices.

As exports increase slowly in the face of sluggish growth and as our competitors fight to keep their markets, what will be the United States' response? More subsidized sales could be one solution. But such subsidies will increase exports only as long as the U.S. Treasury can outbid competitors' treasuries and will only exacerbate current tensions making it more difficult to put agriculture on the GATT agenda. Alternatively, the United States could turn its back on the world market by raising support prices. Ignoring the world market would mean idling up to half of our acreage which would allow our current competitors (and others we haven't even heard of yet) to increase their production and exports and would decrease incentives for the U.S. farmer to continue to produce at low costs. GATT would be a moot point.

Clearly, agricultural negotiations in the GATT are critical for the United States. We cannot expect the macroeconomy to bail us out of

the current crisis, nor can we expect our competitors to move over. But even more clearly, in the present climate, those negotiations will be hard to start much less conduct. How can the United States improve the negotiating climate and what should our strategy be towards those negotiations.

What Is to be Done?

The administration has several goals for agriculture in the GATT round, including putting agriculture on a more market-oriented basis by eliminating export subsidies and by reducing barriers to import. These are admirable goals as far as they go, but we must be more specific.

Currently, the United States operates under one set of trading rules while other countries operate under another set. The Section 22 waiver, which allows the United States to impose import quotas when imports threaten the government's ability to conduct domestic programs, is one such rule. To be considered seriously, we must be willing to put our Section 22 waiver on the table at GATT, even if we receive nothing directly in return.

Further, we must be willing to discuss domestic policies. GATT rules presently discourage export subsidies for primary products, except in certain circumstances. But there is widespread recognition that many countries use domestic policies to directly subsidize farmers and thereby indirectly subsidize exports. All agricultural subsidies—export and domestic—need to be included in GATT discussions because they all have an impact on trade. Unless the United States and other major agricultural producers are willing to talk about harmonizing or coordinating domestic policy sets, negotiations will be meaningless.

Finally, it is important that Congress doesn't tie the hands of the negotiators (Hathaway). We cannot afford to exclude discussions of Section 22 and domestic policies in advance. Excluding these issues will please those countries that want negotiations to fail. Those countries could use U.S. intransigence as an excuse not to participate in the negotiations, thereby dooming negotiations and hopes for a stronger recovery for U.S. agriculture.

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