

Emerging Trade Policy Issues: The Hard Choices

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Agricultural trade policy has been receiving increased attention in the United States for the last few years. The reason is obvious. After a decade during which the value of agricultural exports grew from \$8 billion annually to a peak of nearly \$44 billion in 1981, both quantities and values of exports have fallen substantially. Recent USDA estimates project \$32 billion in farm exports in 1985. In the long history of U.S. agriculture, exports have often been a major force in agricultural prosperity and distress. It is a natural tendency, therefore, to look at export growth as a solution to the dismal state of the farm economy. Unfortunately, poor export performance is only one of a complex array of factors that have contributed to the current distress in agriculture; and many of these factors are jointly related to macroeconomic policies and performance.

The major elements of these changes from the 1970s to the 1980s are noted in Table 1. The economic policies that successfully wrung inflation out of the U.S. economy also slowed economic growth here and in many foreign countries. U.S. inflation rates fell more rapidly than interest rates, causing real rates of interest to rise. The 1981 tax cut reduced government revenues without an associated cutback in government expenditures, causing the federal budget deficit to increase rapidly and put further upward

Table 1. 1980s Economic Environment Compared to 1970s

	1970s	1980s
U.S. Inflation Rate (%)	5 to 10	3 to 5
U.S. Real Interest Rate (%)	-1 to 3	5 to 9
U.S. Budget Deficit (\$ Billion)	-10 to -70	-60 to -180
U.S. Current Account (\$ Billion)	-20 to 20	5 to -120
U.S. Exchange Rate Change	69 to 80 = -29%	80 to 84 = +50%
Net Debt Transfers to Developing Countries (\$ Billion)	78 to 81 = 30/yr.	82 to 83 = -2/yr.
U.S. Ag Export Changes (\$ Billion)	71 to 81 = 35.8	81 to 85 = -11.8
U.S. Ag Program Costs (\$83 Billion)	71 to 81 = 5/yr.	82 to 85 = 14/yr.

pressure on real rates of interest. As foreign investors bought dollars to invest here and earn these high returns, the dollar appreciated and made our exports more costly abroad. The decline in exports relative to imports created a substantial increase in the current account deficit. The world economic slowdown in the early 1980s, combined with high real interest rates and an appreciating dollar, contributed to debt crises in many Third World economies. Public and private debt disbursements to developing countries declined and debt repayments increased until the net debt transfers became negative.

All of these factors contributed to a substantial decline in U.S. agricultural exports from the peak in 1981. Added to this weak demand, the bumper crops in the United States in 1981 and 1982 set the stage for a substantial decline in farm prices, incomes, and land values. Commodity programs designed to provide a measure of protection to farm prices and income absorbed substantial amounts of the growing surplus through building stocks and acreage reductions. Program costs rose to nearly three times the rate of expenditures incurred during the 1970s.

The reversal of conditions that existed before the turn of the decade could hardly be more complete. Exchange rate changes and export declines can be viewed as casualties rather than causes of this turnaround. It is clear that macroeconomic policies have been a major element in this reversal. These large negative impacts of the changed macroeconomic policies on agriculture were not anticipated. In fact, some earlier studies by Tweeten suggested that expansionary monetary policies were harmful to agriculture. More recent studies by Starleaf, Meyers, and Womack (1985) and Devadoss, Meyers, and Starleaf (1985) have provided evidence that farmers are adversely affected by the kind of stringent monetary policies that were initiated in 1979 and carried into the 1980s.

Before proceeding to discuss trade policy issues that have emerged from this wrenching experience, it is important to look more carefully at the patterns of growth and decline in trade that we have experienced. A better understanding of the factors underlying these changes will make it possible to form better judgments about the trade policy issues and options that are emerging.

Sources of Growth and Decline in Exports

For analytical purposes, it is important to separate two components of change in U.S. exports. The first is the total world imports of the commodity, and the second is the U.S. share of those imports. Separation of these two elements helps to distinguish the factors that influence each and to determine the prospects for influencing these factors. Figure 1 shows the pattern of growth and decline in total grain trade for the world and the United States, and the U.S. share. The imports of these commodities nearly doubled from 1970 to 1980. The U.S. production machine was able to quickly respond to this demand growth and increased its share of this trade from 34 percent in 1970 to a peak level of 52 percent in 1979. Much land that was idled by government programs in the 1960s was brought back into production, cropland and irrigation was expanded, and productivity was increased. As a

result, U.S. agriculture became more dependent on export demand, which is far less stable and predictable than U.S. domestic demand.

In the 1980s it is evident that total grain trade exhibited slight variations from year to year but no growth. U.S. exports, however, declined and were replaced by exports from competitors including the European Community. During this period, the U.S. export share declined to 40 percent in 1984 and is expected to be around 38 percent in 1985. Even if the U.S. trade share had been maintained at around 50 percent, U.S. exports in the 1980s would not have experienced any growth.

Because of the relatively large U.S. share in world trade, it has been too easy to think that the world is heavily dependent on us for grain supplies. That is true in the short run, but it is important to remember that even though our exports now represent about 40 percent of world trade in grains, they only represent about 6 percent of world production of these commodities. It is clear that in the 1980s the United States is more dependent on the world market as a source of demand growth, but the world market is not as dependent on the U.S. as a source of supply.

Factors Influencing World Imports

The major factors affecting net import demand in the rest of the world are the rate of production growth in importing countries and the rate of growth income and population on the demand side. Population marches along at a fairly predictable rate, but production growth and economic growth are much more variable and subject to policy influences. The net importing areas of the world for wheat and coarse grains are divided into nine regions in Figures 2 and 3. All of these regions contributed to some degree to the growth in import demand in the 1970s, but China, East Europe, and West Europe (excluding the European Community) had sharp declines in import demand in the 1980s.

The most rapid import growth in the 1970s came from these three regions plus the USSR and the Upper-Middle Income (UMINC) Developing Countries. Japan, the Lower-Middle Income (LMINC) Developing Countries, and the High Income (HINC) Developing Countries show steady rates of growth through the entire period. The low income (LINC) developing countries increased imports rapidly from 1971 to 1974 but then fell off sharply in the following three years and remained fairly flat after that. Two of the three regions where imports fell sharply in the 1980s, East Europe and Other West Europe (excluding the EC), had large increases in production while utilization was fairly constant. In China, utilization increased but production increased much more rapidly than domestic consumption, making import substitution possible. While slowing of demand growth is evident in other regions, it appears that a major factor contributing to the stagnant import growth in the 1980s is the sharp increase in production experienced in Europe and China.

Factors Affecting Trade Shares

Losses in trade share are associated with increased exports of competitors. This could be associated with the appreciation of the dollar, the price levels supported by loan rates in the United States, or policies of competing exporters which induce larger production and/or subsidize surplus commodities in export markets. It is clear from Figure 4 that the exports of the United States were increasing more rapidly than its competitors from the early 1970s until 1980. Then U.S. exports began to decline, while competitor exports continued to grow. A very similar pattern is evident in Figure 5 for soybeans and the soybean equivalent of meal. Note that the turnaround in U.S. exports is coincident with the appreciation of the U.S. dollar relative to other currencies. The higher value of the dollar provides competitors with greater opportunity to sell competitively in international markets.

Looking to the 1990s

Table 2 summarizes the major factors affecting total exports and trade shares that have had important effects on U.S. agricultural exports in the 1970s and early 1980s. In the 1970s, the positive factors overpowered the relatively less important negative factors and generated rapid export expansion. In the first half of the 1980s all of these factors have turned negative.

Looking ahead to the last half of the decade, there appears to be one ray of hope so far. The dollar has been depreciating in value for much of this year and is expected to decline further. There is little hope for improvement of the debt problems in the developing countries, and they could even get worse before they get better. The other factors are more uncertain. The FAPRI (1985) projections based on the macroeconomic forecasts of Wharton Econometrics, and assuming a movement toward market oriented loan rates in the United States, do not provide a very bright outlook. Even with substantial declines in the value of the dollar and continued low commodity prices, U.S. exports by the end of this decade still do not recover their peak levels achieved at the beginning of this decade.

Trade War or Trade Policy?

As the size of the export pie has stabilized, the conflicts over shares of the pie have increased. The most vocal disputes have been between the

Table 2. Impact on trade of factors influencing total grain demand and U.S. trade shares over three time periods.

Factors	1970s	1980-85	1985-90
Total Imports			
Importer's production	Negative	Negative	?
Importer's income growth	Positive	Negative	?
Net debt transfer	Positive	Negative	Negative
U.S. Trade Share			
U.S. dollar value	Positive	Negative	Positive
U.S. ag. policies	Positive	Negative	?
Competitor ag. policies	Negative	Negative	?

United States and the EC over export subsidies, but there have also been conflicts with Canada over pork trade and with Japan over market access for several commodities. Within the U.S. the growing commodity surplus problem and its rapidly rising cost to the Federal Treasury is creating conflict between those who would cut agricultural prices free to seek "Competitive" levels and those who seek an increase in price and income support. The lack of a clear and comprehensive policy on agricultural trade has given rise to ad hoc approaches to the problem. Examples of these "trade war" options are discussed, and then some ideas on a "trade policy" approach are suggested.

Export Subsidies

There has been much talk and some action concerning export subsidies to counter and make more costly the subsidies designed of the EC. The latest of these ideas is the export PIK program, where surplus commodities are used to subsidize the exports of the same commodity. Unlike a cash subsidy, the payment-in-kind has the effect of adding more grain to the market. It is not certain that this form of subsidy would enhance domestic market prices, since it increases market supplies. Even cash subsidies are of dubious value to a large exporter such as the United States. If such programs are limited to targeted markets they will have a negligible impact on total exports. If they are applied across the board, the costs could be prohibitive. Moreover, providing (at government expense) cheap feed to foreign livestock producers while keeping U.S. grain prices at a higher level is not likely to be a cost effective means of improving U.S. farm income.

Retaliation

Most of the recent export subsidy actions have been directed against the EC in retaliation for the export subsidy they have routinely used. Aside from scoring political points on the homefront and antagonizing an ally, it is not clear that these actions have achieved anything. A little bit of introspection should tell us that political pressure from outside the country is not likely to have much influence on domestic agricultural policy decisions. It is the domestic policies in the EC that create the need for export subsidies and other surplus disposal programs. Like the United States, the EC has been forced in recent years to access its domestic agricultural policies because of the increasingly high cost of the programs. These pressures have brought about some reduction in the support levels for commodities as well as supply adjustment programs for dairy and wine production.

The high levels of price supports maintained by the EC were relatively easy to continue as long as the EC was a net importing country. As a net exporter of some commodities, it finds itself under a different set of pressures that are beginning to have an effect on internal policy decisions. A recent study by Meyers, Thamodaran, and Helmar (1985) found that the slowing rate of income growth in importing areas and the appreciation of the U.S. dollar had five times more impact on the value of U.S. exports than did the increasing level of support prices in the EC. These results suggest that while the domestic agricultural policy of the EC has a negative effect on U.S. agriculture, it is not likely that a reversal of those policies would substantially improve the U.S. export performance. The United States and the EC both face substantial surplus capacity problems which were in part brought on by policies which induced the expansion of productive capacity and resources in agriculture. Both face serious adjustment problems in the years ahead and need to find ways to maintain a vital agricultural industry under increasingly difficult budget and market conditions.

Trade Policy

Recognizing the factors that have combined to stifle the growth in U.S. exports, it is possible to outline the elements of a trade policy which would address this problem. To effect the range of factors enumerated above requires a trade policy that goes beyond traditional agricultural policy boundaries. It needs to recognize that the major growth areas for agricultural exports in the future are the developing countries. Many of these potential markets are now choked with credit constraints, debt service problems, slow economic growth, or all of these. Effective action on these problems requires not only a broadly based U.S. policy, but also a collaboration with other developed countries. Although multilateral cooperation is always difficult, enlightened self-interest could motivate the EC, Canada, and Australia, for example, to cooperate.

The primary thrust of the trade policy approach is to restore effective demand growth for agricultural commodities. The instruments to increase the purchasing power in developing countries would include the macroeconomic policies of the United States and other developed countries, the credit

policies of private and public institutions in the developed countries, the trade policies of developed countries toward the export goods of the developing countries, and economic development assistance. Based on past experience, it is likely that North-South trade will be much more effective than development assistance in achieving economic growth and development in the developing countries.

Some of these initiatives are obviously long-term in nature, but credit and trade policies need not take a long time to have a significant effect on purchasing power. Such a trade policy approach recognizes once again that agriculture has become completely integrated into the domestic and international economies and relies heavily upon factors outside of agriculture to generate the growth that agriculture will need to remain a vital sector of the economy in the rest of this decade and beyond.

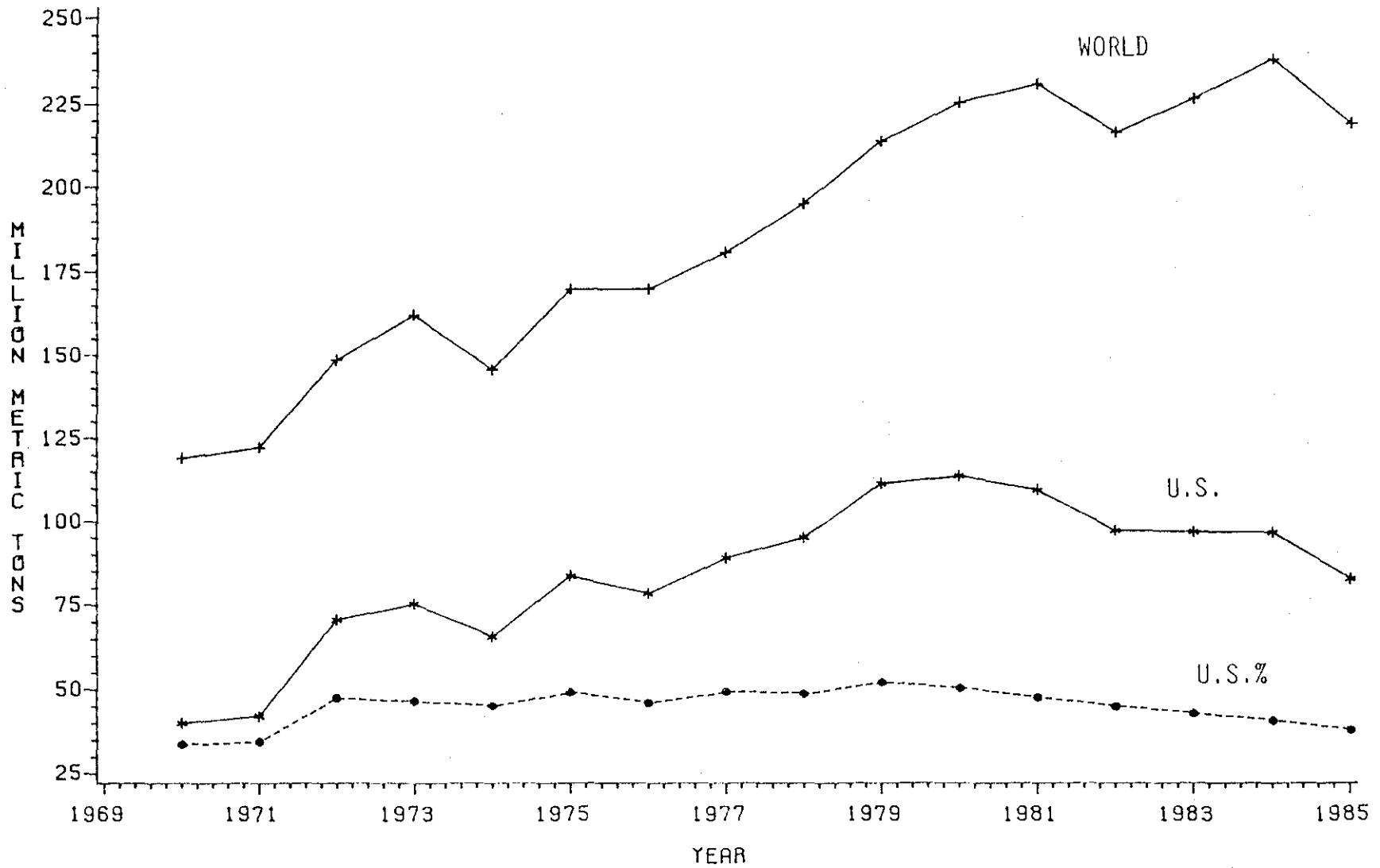
Conclusions

The dramatic turnaround in agricultural exports of the 1980s was the result of numerous factors which combined to reduce the growth in world trade in the key agricultural commodities as well as the U.S. share of this trade. It is a fact of life for a major exporter like the United States that export growth is dependent upon growth in total trade. To focus our energies and resources on attempts to get a larger share of the shrinking pie is a wasteful endeavor. It is always easier for the small trader to win such battles. It is more difficult to formulate a more general, comprehensive trade policy to deal with the problem, but that is a task that provides some hope for success.

The conditions that have brought us to this point in the 1980s appear likely to continue for the rest of the decade. Grain export demand in the next five to ten years is expected to grow rather than decline, but growth is likely to be much slower than that of the 1970s. The prospects for the United States and the EC and other exporting countries to reach agreements on cooperative production adjustment programs or negotiate market shares are dim. However, there should exist a mutual interest in restoring effective demand for agricultural imports in the developing world. Current unilateral export expansion programs by individual countries are short-sighted in their focus on increasing market share and have little impact on increasing market size.

A well conceived trade policy that would include improvement of credit conditions, terms of trade, and development assistance to developing countries would be more effective than the sum of the unilateral efforts that now exist. The real choice is between a comprehensive long term trade policy and a continuation of short-run ad hoc reactions to trade problems.

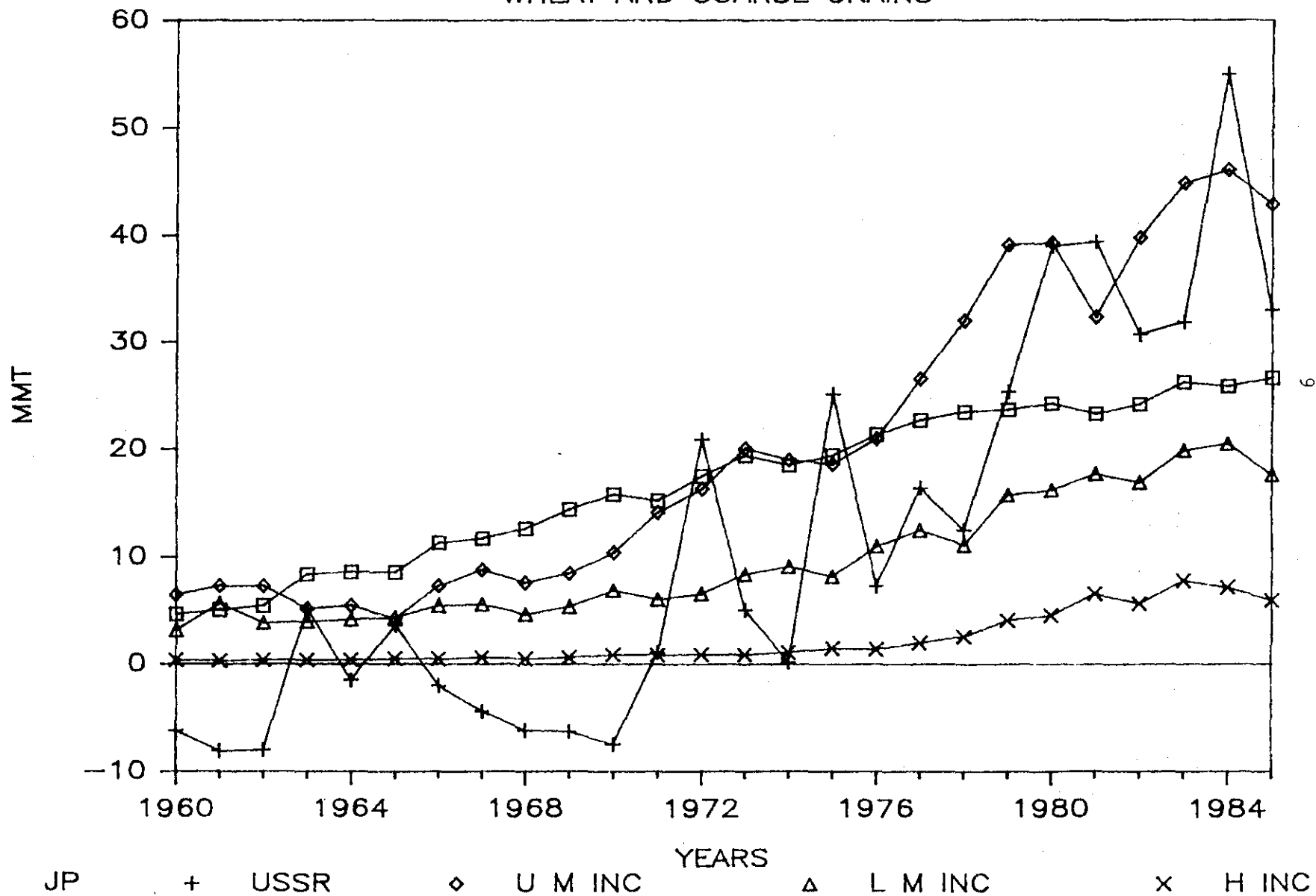
FIGURE 1.
 WORLD AND U.S. TOTAL GRAIN TRADE
 1970-1985



WORLD = +
 U.S. = *

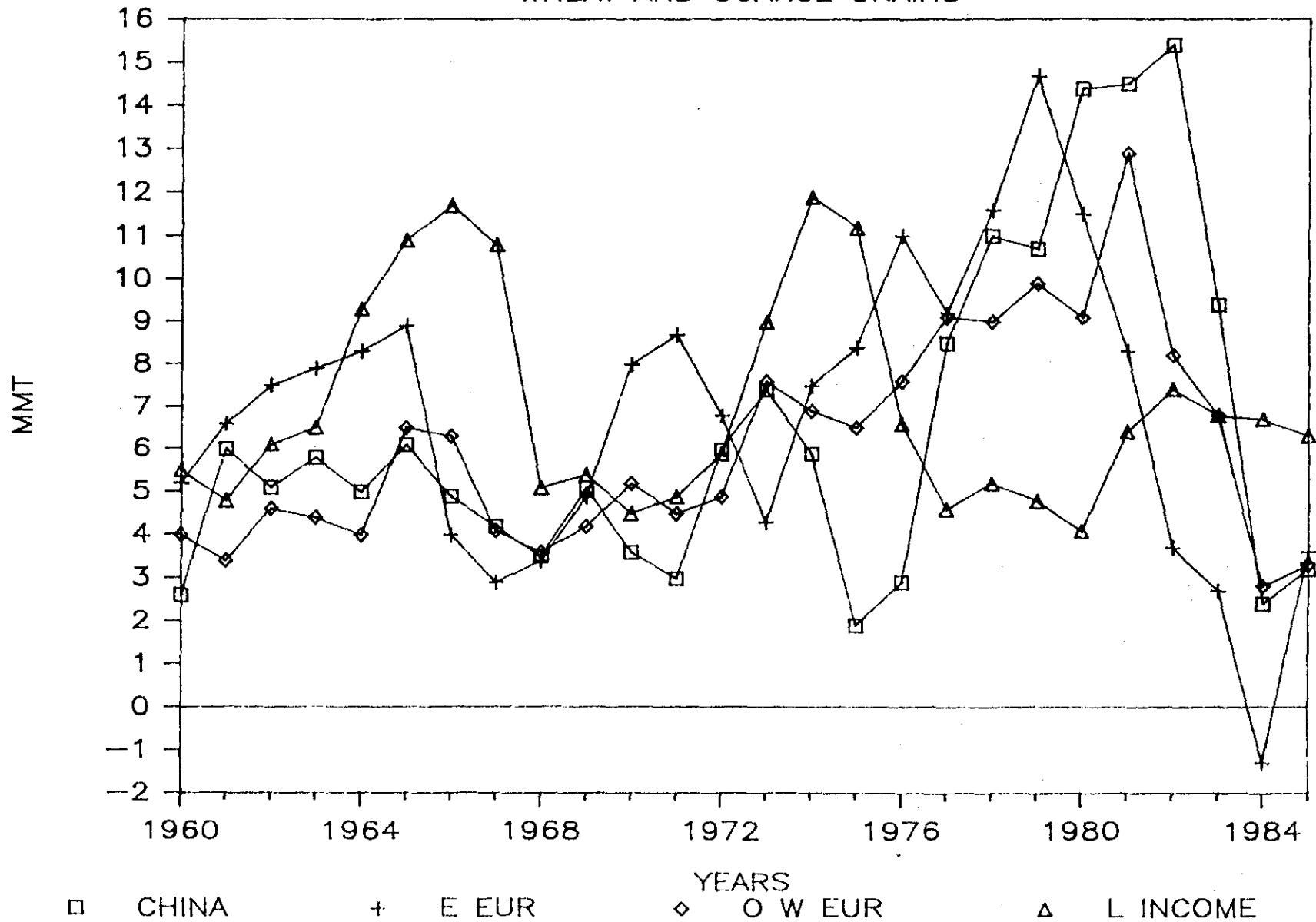
SOURCE: CARD/TRADE AND AGRICULTURAL POLICY DATA SYSTEM

FIGURE 2.
NET IMPORTS GROWING
WHEAT AND COARSE GRAINS



SOURCE: USDA, FOREIGN AGRICULTURE CIRCULAR, GRAINS, FG-13-85, OCTOBER 1985

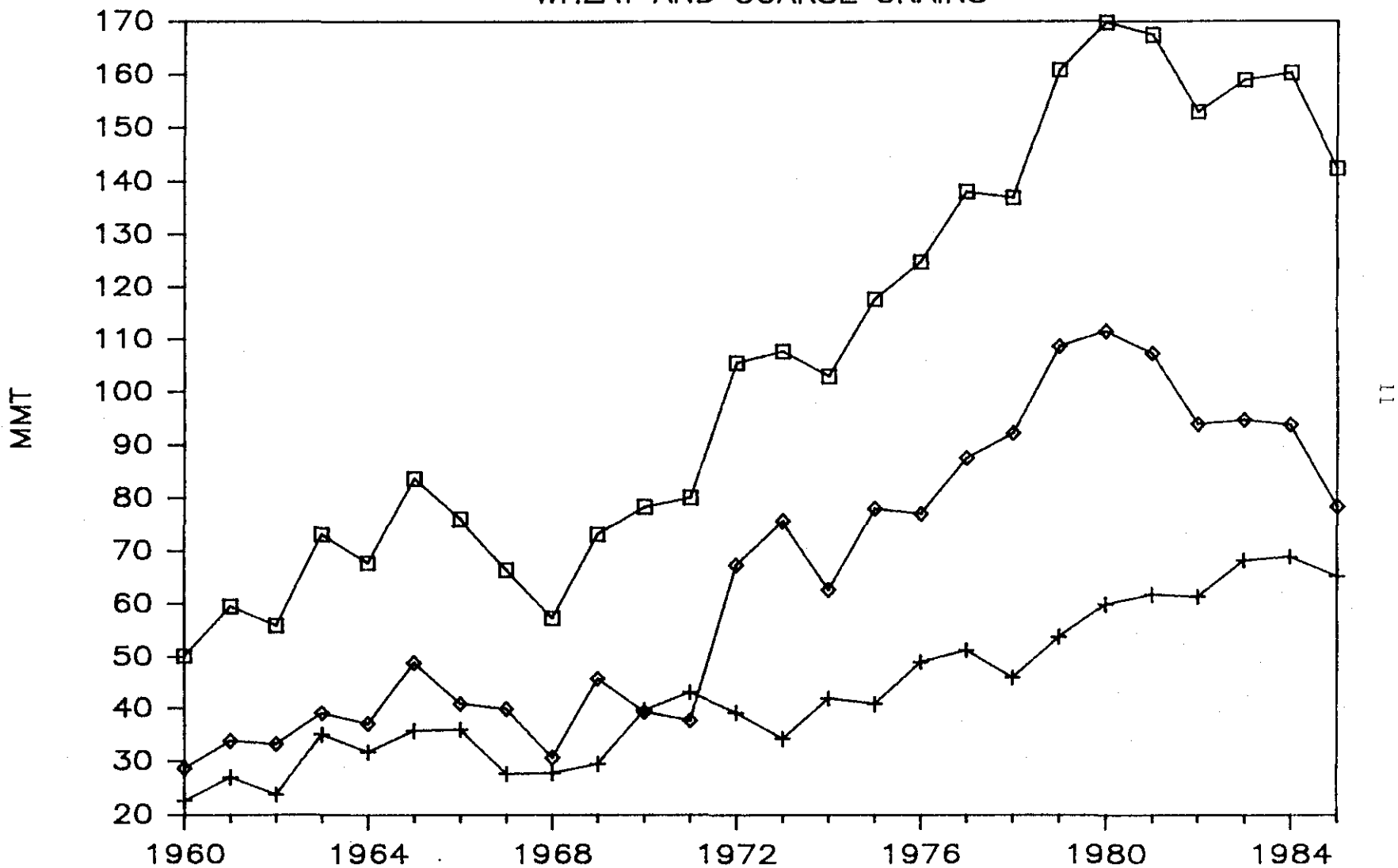
FIGURE 3.
NET IMPORTS DECLINING
WHEAT AND COARSE GRAINS



SOURCE: USDA, FOREIGN AGRICULTURE CIRCULAR, GRAINS, FG 13-85, OCTOBER 1985

FIGURE 4

COMPONENTS OF WORLD GRAIN TRADE WHEAT AND COARSE GRAINS

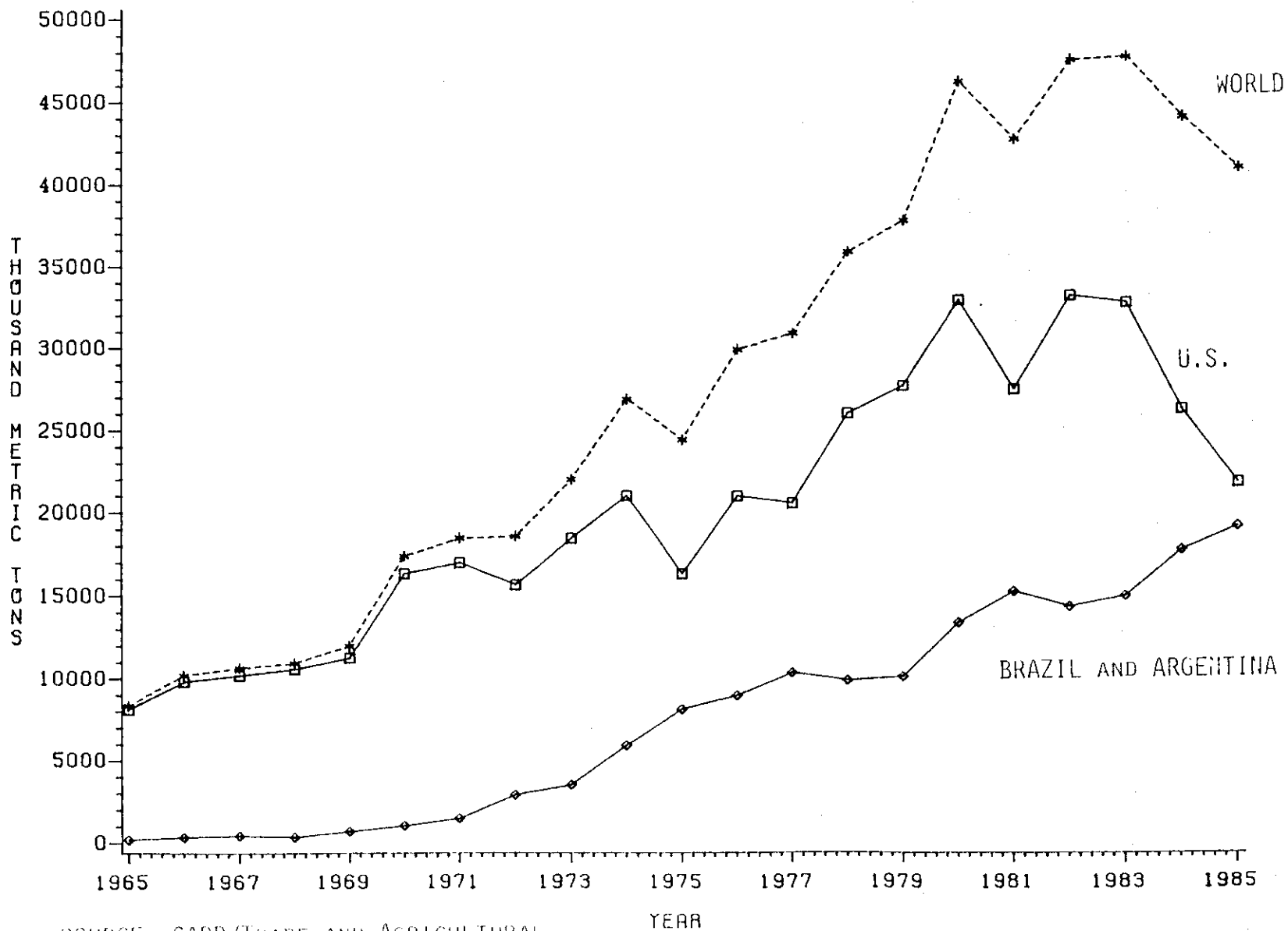


□ NET IMP (INCL EC)

+ COMP EXP (EXCL EC)

◇ U.S. EXP

FIGURE 5.
 SOYBEAN PLUS SOYBEAN EQUIV. OF MEAL
 MAJOR EXPORTERS (1965-1985)



SOURCE: CARD/TRADE AND AGRICULTURAL
 POLICY DATA SYSTEM

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