



Global Policies & U.S. Agricultural Trade

by Valerie L. Vantreese and Peter K. Karungu ¹

This is the fourth in a series of four fact sheets designed to educate Kentucky farmers and agribusinesses on macroeconomic policies and how they are linked to agriculture.

Fact Sheet I provides a general discussion of the domestic policy process, identifies the major players, defines various macroeconomic policy tools, and discusses their linkages to the agricultural sector.

Fact Sheet II reviews the effects of macroeconomic policy changes on U.S. agriculture during the 1970s and 1980s and suggests how potential macroeconomic policy changes could affect U.S. agriculture during the early 1990s.

Fact Sheet III analyzes the impacts of macropolicy changes on Kentucky agriculture and rural communities.

This fact sheet (**Fact Sheet IV**) discusses the changing international trade policy environment and its potential impact on the U.S. agricultural economy.

The series also includes a glossary of macroeconomic policy terms.

Introduction

The U.S. has maintained an agricultural trade surplus since the late 1950s, as agricultural exports have consistently exceeded imports. However, U.S. agricultural exports have been quite volatile for the last twenty years as we gained and lost world market share. Why has U.S. agriculture been subject to such export volatility? Part of the answer may lie in understanding trade policy within the context of international trade agreements and trade policies.

The Outcry for Free Trade

As international trade has become increasingly important and trade imbalances continue to be a topic of concern, domestic agricultural and trade policy are subjects of debate. From the protective Common Agricultural Policy (CAP) of the European Community (EC) to the complexity of the Japanese distribution system, international agricultural trade policies are open to world scrutiny. Trade liberalization is the catch phrase as recent negotiations have moved to reduce or eliminate barriers to trade such as quotas, tariffs, and subsidies. Attempts to resolve trade disputes result in heated dialogue as nations firmly defend their respective policies.

Advocates of free trade argue that all nations would benefit and global welfare would be maximized if all trade-distorting practices were removed. As countries specialized and became more efficient, world productivity

¹Senior authorship is shared.

would increase. Countries with abundant capital, like the U.S., Japan, and Germany, would specialize in capital-intensive goods, while less developed nations with abundant labor would specialize in labor-intensive goods.

Unfortunately, such an environment is more of an illusion than reality. World trade is affected by a multitude of protective measures adopted by various nations to improve their trade positions or protect domestic industries. Domestic agricultural policies (e.g., set-aside requirements, production quotas, target prices, and loan rates) are implemented to ensure security and stability in food supplies and to support farm income. However, these measures distort world commodity production, prices, and trade patterns.

GATT and Agriculture

To enhance trade among nations, the General Agreement on Tariffs and Trade (GATT) was established in 1948 to restore order to the world economy after the massive destruction and economic depression following World War II. This body is responsible for advocating policies that would improve trade among nations and for ensuring adherence of these policies by all member nations.

Based in Geneva, GATT has nearly 100 member nations and accounts for over four-fifths of world trade. GATT treaties cover trade of both agricultural and nonagricultural goods and are extending their influence to the trade of services, investments, and intellectual property rights, such as patents. While many disputes have been resolved within GATT, no specified mechanism exists for enforcing trade rules and regulations beyond the respect and compliance of its constituents.

Historically, GATT has given special exemptions to agriculture. For example, tariffs and quotas are permissible on agricultural imports that compete with domestic farm production. Production and export subsidies are also allowed, with only a weak requirement that the subsidizing country discuss its policies with those countries that would be affected. In essence, GATT permits current protectionist farm programs to exist without violating GATT treaties. Ironically, these domestic programs are the major drawback to further liberalizing GATT rules in agricultural trade.

The Uruguay Round, begun in 1986, made agriculture one of the top priorities. Recent discussions maintain that the U.S., EC, and other GATT members must eliminate domestic farm policies that distort agricultural trade. During the fall of 1989, several nations within GATT submitted proposals to reduce agricultural trade interference. The United States, Japan, and numerous industrialized countries advocated the elimination of

most trade-distorting farm support programs, but permitted farm income enhancement through other means.

The U.S. agricultural proposal to GATT, submitted in October 1989, essentially protects farm income but does not distort trade. The U.S. recommendation emphasizes trade liberalization through the gradual elimination of all farm subsidies that distort trade. For example, the U.S. has advocated eliminating all production quotas and price support systems, but would permit income transfers to the farm sector if such income supplements were not based on individual production levels and/or crop selection. While farmers in some countries would suffer losses, other farmers would gain due to increased market access. Gains would accrue to consumers through lower taxes and more plentiful and varied food supplies.

Studies show that if complete trade liberalization was achieved, world trade would increase by about 10% and world prices of most commodities would be slightly higher. Net U.S. farm income would be expected to fall 10-15%, unless other income compensation was provided. However, the U.S. economy would gain almost \$4 billion due to lower government expenditures used for agriculture subsidies.

Given complete trade liberalization, world sugar and dairy prices would increase the most (in percentage terms), with small price increases expected for beef, rice, and grains. U.S. agriculture would benefit in those areas in which we have a production advantage -- feed grains, livestock products, and poultry. Shifts in production might occur for bulk commodities. For example, if U.S. sugar and dairy import quotas and rice production subsidies were removed, these industries might further concentrate in developing countries due to labor cost advantages.

U.S. tobacco and beef producers face some of the toughest trade barriers abroad. Further trade liberalization would continue to open markets in the Pacific Rim and other Asian countries. Currently the U.S. is a net importer of beef (we import more low-quality beef than we export high-quality beef); with complete trade liberalization the U.S. would become a net beef exporter.

U.S. grain farmers would benefit from the increased production of grain-fed beef here in the U.S. and from the removal of foreign grain export subsidies (particularly in the EC). However, U.S. feed production would fall slightly as world price increases would not completely compensate for the elimination of U.S. government subsidies.

As world food prices "evened out," more of an emphasis would be placed on product quality, particularly for processed foods. If sanitary regulations were harmonized or made more

consistent across national borders, processed food trade could increase dramatically. With modern food processing technology, the U.S. would stand to benefit from increased processed food exports.

The chief adversary of the U.S. proposal is the European Community. The EC wants to allow many trade-distorting farm policies to remain intact in the foreseeable future by "rebalancing" or shifting heavily subsidized commodity expenditures to other commodities (e.g., reducing grain and increasing oilseed support). Thus far, the EC has not been very effective in convincing GATT members of the benefits of their re-balancing plan, and future farm production patterns may depend on European ingenuity to protect farm income. Europeans, especially Germans, are determined to continue protecting their farm sector and currently use a variety of policy alternatives to do so. At the last formal meeting of the Uruguay Round in December 1990, the agriculture committee was unable to compose a rough-draft for final negotiations due to EC opposition.

Demonstrations, sometimes violent, by members of the European Community (both farmers and consumers) were evidence of the strong position the EC has taken not to compromise their domestic farm programs. The talks collapsed, and the failure to agree on agriculture caused non-agreement on other GATT issues. Although this failure to agree was a severe blow to the U.S. and most of our trading partners, the issues raised and discussions ensued will provide a stage for future negotiations. It is very likely that failed multilateral trade talks will result in strengthened bilateral trade agreements.

Canada/U.S. Free Trade Agreement

Bilateral trade agreements can be relatively simpler, quicker, and more effective than multilateral trade agreements acquired through GATT. An example of a successful bilateral trade agreement is that between the U.S. and Canada. The shared border between the two countries has led to a natural trading relationship; we are each other's largest trading partner.

However, accumulated trade barriers between our countries -- import licenses, quotas, tariffs and subsidies -- had restricted both agricultural and non-agricultural trade between the U.S. and Canada.

Implemented Jan. 1, 1989, the primary objective of the Canada/U.S. free trade agreement (FTA) is trade liberalization through the removal of various tariff and non-tariff trade barriers. The highlights of the FTA include:

- (1) *eliminating most tariffs over the next ten years,*
- (2) *making product standards consistent (harmonization),*

(3) *giving "national treatment" in trade of services and investment and*

(4) *eliminating import and export quotas unless consistent with GATT or the FTA itself.*

Although much of Canada/U.S. trade was already duty free before the FTA was signed, this agreement has important ramifications for trade between our countries.

Harmonization of product standards (packaging and labeling laws, the use of color additives, pesticide use, etc.) is particularly valuable for the processed food industry. Dairy, fruit, vegetable, meat, and egg inspection will also be more consistent between countries.

These changes are expected to increase U.S. exports of fruits, vegetables, wine, honey, and wood products. Grain (including wheat, oats, and barley) and oilseed trade might also be enhanced as Canadian grain import licensing requirements are relaxed.

"National treatment" decrees that subsidiaries of U.S. companies operating in Canada will be treated as Canadian companies and vice-versa. This ruling will allow firms to take advantage of more lenient domestic business licensing laws and will have important effects on accounting and taxation. National treatment laws will allow food processing companies to locate where procurement and consumer conditions mandate, rather than where national laws dictate. The same is true for agricultural services, such as custom harvesting, spraying, machinery repair, etc.

Our similarities with Canada -- politically, culturally, and economically -- played an important role in the ease of creating a successful FTA and, equally important, provided the framework for future negotiations. (It should be noted that these similarities are missing from current U.S.-Mexico Free Trade Agreement discussions.)

Other countries have criticized the U.S. and Canada for distracting their efforts from GATT negotiations. Proponents have argued that the success of the FTA is the realization of free-trade aspirations, consistent with the heart of GATT, and a demonstration of how standards can be harmonized to the satisfaction of all parties involved.

European Community Unification

The economic, political, and cultural unification of the European Community (EC) has been a long process (begun shortly after World War II) that is difficult for many Europeans to understand, let alone those outside of Europe. The 12 countries that formally make up the EC (Belgium, Luxembourg, Greece, United Kingdom, Germany, Spain, France, Italy, Portugal, the Netherlands, Ireland, and

Denmark) are attempting to dissolve the boundaries which restrain the flow of people, goods, and services. The primary methods of unification include:

- 1) *eliminating physical barriers that necessitate border controls,*
- 2) *dissolving technical barriers to trade, and*
- 3) *further removing distortions to competition.*

With an anticipated completion date of Jan. 1, 1992, EC directives (laws) will replace up to 80% of existing national laws. These changes affect everything from mortgage rates to the location of physicians' offices. Although complex and a hot-bed of national protectionism, EC unification should lead to a larger, more competitive, and more efficient marketplace.

How will EC unification affect agricultural trade with members of the Community? Perhaps surprisingly, EC'92 will have little effect on raw commodity production and trade in the EC. The majority of U.S./EC agricultural trade is in bulk commodities and before the mid-1980s included grain and livestock products. However, the EC employs domestic agricultural policies (through CAP -- Common Agricultural Policy) to promote agricultural trade between EC members. Recent CAP programs have stimulated EC agricultural production, particularly feed grains, through production subsidies and price support programs.

In addition to production incentives, the CAP discourages agricultural imports (through variable levies or taxes which make imports more expensive than EC-produced commodities) and encourages exports (through export price subsidies). These policies have shifted the EC from a net grain importer to a major exporter, making it a U.S. competitor for grain products. Thus, changes in EC agricultural competitiveness are more dependent on changes in the CAP agenda than on EC unification.

EC unification will have more impact on value-added trade. The removal of internal European Community boundaries should simplify exporting processed foods to the EC, as U.S. firms will face one set of technical regulations instead of 12 separate sets.

Harmonization will come in the form of standardized plant and health regulations; food labeling, ingredients, and packaging laws; and the elimination of agricultural border taxes and subsidies. For example, a U.S. confectionery company will face the same set of regulations exporting chocolates to Germany as it would to France. However, the tendency in current EC negotiations has been to adopt the most stringent regulations possible, instead of the least prohibitive.

In addition, the benefits of harmonized standards affect not only the U.S., but also EC members and other countries trying to export to the EC. Hence, EC imports of processed foodstuffs will remain

highly competitive, rigid to the EC standards, and as dependent on quality as on price.

To avoid possible market exclusion, many companies have moved their processing plants to the EC to take advantage of equal treatment laws, thereby earning U.S. companies operating in the EC the same benefits awarded to EC national companies. (Twelve of the top 20 EC food processing companies are U.S. controlled.)

Given the size of the European Community (320 million consumers), the world is cautiously watching EC unification. The scrutiny and heated debates generated by EC agricultural policies and EC unification are unprecedented. A strong but protective EC would undermine the U.S.'s ability to compete not only in the EC, but in other markets as well. Domestic agricultural policy can be just as powerful as trade and fiscal policy in defining trade relationships.

Democratization of Eastern Europe

The democratization of many Eastern European countries (Poland, Yugoslavia, Romania, Hungary, Czechoslovakia, and Bulgaria) may re-define our trade with Europe in years to come. As these countries attempt to incorporate more market-based principles into their economies, their export sectors should grow, further expanding opportunities for import growth.

Exports from these centrally planned economies continue to be inhibited by inferior goods, primarily a result of outdated production processes and inefficient input distribution systems. Current underproduction cannot meet domestic demand. Unless significant improvement in production is realized, increased exports from Eastern Europe will add upward pressure on previously subsidized domestic food prices.

Considerable capital is needed to modernize the production, manufacturing, and distribution sectors of Eastern Europe before these countries can compete in world markets. Consequently, raw commodity exports -- such as hardwoods, grain, and pork -- will continue to dwarf processed food exports for quite some time. Logical export markets are Western Europe, although CAP may surpass natural transportation advantages.

Eastern European import demand is constrained by lack of foreign exchange (earned primarily through exports). Simply put, foreign companies do not want to be paid for their exports in Polish Zloty which cannot be traded on international financial markets. Without exports, foreign exchange earnings are further constrained and serve to compound pent-up consumer demand.

On a more optimistic note, Eastern European countries have relatively high per capita incomes compared to less developed countries and are strategically located between continental Europe and the Middle East. With an educated work force, ample natural resources, and the availability of capital, a peaceful transition to democracy could place the centrally planned economies of Eastern Europe in a pivotal position.

In addition, these countries have strong ties -- economically, politically, and culturally -- with the rest of Europe. West and North European investment to aid Eastern Europe (both private and public) will go a long way in further fostering these bonds.

Developing Countries

The importance of agricultural trade between developing countries and the U.S. should not be overlooked. In 1989, more than half (52%) of U.S. agricultural import trade and 41% of export trade was with the developing world. Developing countries in Latin and South America continue to export increasing amounts of commodities that the developed world demands -- fresh fruit and vegetables, coffee, tea, and fish -- and import increasing amounts of processed food products and grains.

However, many developing countries continue to battle deteriorating natural resources, an uneducated and malnourished workforce, inadequate infrastructure, and political instability. These countries (those in Africa, particularly) will continue to be strong markets for U.S. agricultural products in the form of food aid, under the PL 480 Food for Peace Program, and other food assistance programs.

Although most developing countries in the Western Hemisphere continue to maintain a net agricultural trade surplus, that position weakened during the 1980s. Coupled with falling oil prices, increasing food needs, and exploding Third World debt, most developing countries are in a precarious position. In addition, developing countries have suffered from increased trade protectionism by many developed countries in the wake of the global recession in the early 1980s.

Exports are essential to help developing countries earn foreign currencies in order to repay their debt and further strengthen their economies. However, many developing countries overvalued their currencies in the early and mid-1980s, making their exports overly expensive. Further, overvalued currencies make imports cheaper, which helps alleviate consumer demands, but discourages domestic production. Ironically, these policies compounded their debt problems and worsened their balance of trade.

To deal with the debt and trade problems of developing countries, the Brady Plan (devised and advocated by the U.S.) restructured debt payments, and stringent monetary controls were implemented by the International Monetary Fund. These efforts have stabilized their economies and hopefully, gains through economic growth will improve their balance of payments and increase their agricultural imports. However, improved trade relationships rely on foreign investment to provide the infrastructure so sorely needed in developing countries. Manufacturing and processing plants are needed to export value-added and processed food products.

Summary & Conclusions

Policy changes both here and abroad have significantly affected U.S. agricultural exports. Farmers and agribusinesses can expect continued volatility in international trade policy through the next decade. Projections of U.S. agricultural trade in the 1990s and beyond look bright, but will depend on our ability to compete in a more competitive global economy. U.S. domestic and international policies must reflect global policy changes. Trade agreements will depend on intricate and frequent negotiations to ensure stability in agricultural trade. Increased market accessibility will boost U.S. agricultural exports and improve farm incomes.

Finally, economic strength and political stability in our trading partners is the underlying force in increasing U.S. exports. Restructuring and provision of the much-needed financial assistance to the developing and Eastern European countries will stimulate demand for U.S. products. Interwoven trade and monetary policies will continue to integrate the global economy, with repercussions on world commerce patterns.