Domestic Farm Programs and World Trade

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At the economic summit in Bonn in early 1985, the Reagan Administration proposed that new trade liberalization talks begin in 1986. Agricultural issues are high on the priority list. Previous trade talks have done little to reduce barriers to farm trade. These barriers are hard to reduce because of countries' tight linkages between domestic agricultural programs and world trade.

All countries have their own farm and food programs. Depending on how the programs are run, they may create food surpluses or shortages. Countries look to the world market to absorb their surpluses or cover their shortages. But, at the same time, they shape their domestic programs to protect their farmers and consumers from world market swings. Attempts to liberalize world trade conflict with the sovereign power of countries to pursue their own production and consumption interests.

Domestic agricultural policies of the United States and other countries do affect agricultural trade in a major way. They affect the volume, the prices at which goods are traded, and the volatility of the world market. Various countries have many different kinds of

The White House

President Ronald Reagan, Secretary of State George Shultz, and Secretary of the Treasury James Baker at the 1985 economic summit in West Germany proposed new trade liberalization talks. Agriculture was high on the priority list.

programs that can be grouped into two general categories: producer-oriented programs and consumer-oriented programs. One protects farmers and usually leads either to surplus production that is dumped on the world market or to protection from cheap imports. The other favors consumers, fixing farm and food prices at low levels that lead to domestic food shortages and the need to increase imports. Developing countries typically favor the consumer, industrialized countries the farmer.

Policies of Developed Countries

The developed countries over the last 50 years have had relatively poor farm sectors, so they have focused on policies that support farm income, often at the expense of taxpayers and consumers.

Farm Support Prices. Farm support prices are frequently set at levels higher than the market will bear, thereby encouraging production, and discouraging consumption. If the country is an exporter, its exports fall and supplies increase. It then must subsidize exports or cut production to reduce burdensome stocks. If the country is an importer, increased production and re-

duced consumption thwart imports. If the price supports are high enough above world market prices, the importing country can become an exporting country. The effect of these types of policies on world market prices is to lower their level but make them more unstable. Lower world prices occur because the producer-oriented policies reduce imports and encourage exports. Price instability grows because domestic price supports above market-clearing levels inhibit production and consumption adjustments.

A wide variety of producer-oriented policies are used by the developed countries, and the effects vary greatly. Japan sets both consumer and producer prices for wheat and rice well in excess of world prices, with the producer price being higher than the consumer price. As a result, wheat imports are lower, and rice production and stocks are higher than otherwise would be the case. The imbalance in rice has become so great that on occasion Japan has subsidized rice exports and feed use at considerable taxpayer expense.

The European Community (EC) also has set price supports well above market clearing levels. The result has been to encourage the displacement of grain with imported nongrain substitutes, such as manioc, corn gluten, and soybean meal. Grain production in the EC has been encouraged. Until the middle 1970's, subsidies for wheat feeding were used to control stock levels. Since the middle 1970's, the EC has been increasing its subsidized wheat exports and is now a major net exporter. Recently, the use of export subsidies for barley also has enabled the EC to become a net exporter of feed grains.

Argentina and Brazil, major competitors with the United States in world grain and oilseed export markets, generally rely on producer support prices set below world market levels to support their agricultural sectors. Consequently, these support prices add to supply only when prices fall to support levels.

Marketing Boards. Canada and Australia use marketing boards and price pooling to assist their agricultural sectors. Although the basic orientations of their policies are similar, the operational details differ between countries and by commodity. In both countries producers receive a first advance

NFB Canada

Grain marketing in Canada is governed by a centralized marketing board system that has a broad impact. (Canada, government train and grain elevator.)

from the marketing boards, serving as a guaranteed price for producers on grain delivered to the board. In Australia all grain moving off the farm is sold to the board. Canada's delivery quotas generally restrict how much producers can sell to the board. Canadian grain not delivered to the board is either sold at lower prices for feed within the province, or stored on farms. The grain delivered to the boards is pooled and sold. If pool receipts exceed board costs, then the difference is returned to producers in subsequent payments. If there are net losses, producers receive the first advance only. Centralized marketing in Canada and Australia has the po-

tential to increase and stabilize producer returns. Despite numerous studies comparing U.S., Canadian, and Australian prices, however, no consensus has emerged about whether prices are higher and more stable through board marketing.

U.S. Farm Programs

Like other high-income countries, the United States has many programs to help farmers. All affect world trade to some extent. Taken together, they have an especially large impact upon agricultural trade because of the U.S. dominance in global production, consumption, and world market share.

Cotton and Grains. The United States exports the most cotton, wheat, and feed grains, and next to the most rice. Farm programs for these commodities have similar impacts upon world trade—they support and tend to stabilize the world price because the United States holds its surpluses in the form of government controlled stocks. As a result of the artificially high price, foreign producers increase production and foreign consumers use less. Consequently, U.S. exports fall, stocks accumulate, and eventually production must be controlled.

The accumulated U.S. stocks tend to add stability to the world market by being available to use when someone in the world runs short. But the stocks can become burdensome. The Payment-in-Kind (PIK) Program in 1983 was a dramatic example of a program both to cut production and reduce the record stock surplus.

Supporting world prices, reducing U.S. exports, and adding stability to the world market are unintended side effects of programs to help U.S. farmers. But these side effects have more of an impact upon world trade than many trade policies specifically pursued for that purpose.

Tobacco. The United States also exports the most tobacco. As with grains and cotton, the tobacco program supports the domestic and world price of tobacco using Government accumulation and production controls. But the tobacco program does not restrict imports. In fact, the high domestic price support discourages tobacco exports and encourages imports. In recent years this has caused U.S. losses in both the world and domestic markets. For example, in 1970 the United States imported less than 1 percent of domestic use

of flue-cured or burley—the main types of tobacco our farmers grow. But by 1982, imports were 20 percent of consumption of these types even though the United States was still the world's leading exporter.

Sugar and Dairy. Domestic sugar and dairy programs support farm prices well above world prices. The United States is a net importer of sugar and dairy products, but imports are limited by quotas that protect U.S. producers. Without the protection of these programs, the United States would produce less sugar and dairy products and import substantially more. Unlike the other farm programs, these tend to decrease the stability of the world market. The quotas insulate the U.S. from shortages or surpluses abroad, forcing all the adjustment on unprotected countries.

Indirect Subsidies. Indirect subsidies, such as special breaks for suppliers to farmers, are designed to lower the cost of farming thereby stimulating output and, ultimately, exports, and lowering world prices. Several policies subsidize farmers' inputs. Various programs provide credit at below-market interest rates. Examples include short-term commodity loans, grain storage facility loans, long-term loans to high-risk beginning farmers, and disaster loans. Barge transportation of grain also is subsidized because the Federal Government maintains the waterways. The largest input subsidy in recent years was the control of energy prices. Another type of input subsidy is the preferential treatment of agriculture in the tax code. The general effect is to stimulate investment and expand agricultural production. The impact is larger in years when producers' incomes are high.

Policies of Developing Countries

The food and agricultural policies of developing countries tend to favor urban consumers at the expense of farmers.

Price Ceilings. Consumer-oriented policies hold down the price of major commodities through price ceilings. Prices below world market levels discourage production and encourage consumption. These internal adjustments encourage imports, or discourage exports, raising world market prices. Price ceilings also inhibit internal adjustments to altered market conditions. They keep in-

World Bank

The food and agricultural policies of developing countries frequently favor consumers at the expense of farmers. (Brazil, grain farmer.)

ternal prices from fully responding to changes in world market prices. As a result, these policies force greater adjustments elsewhere and increase world price swings.

A consumer-oriented policy initially pays high political dividends by transferring resources and income from rural areas to politically vocal urban groups. Because of the sensitivity of consumers to food price increases, removal of consumer-oriented policies entails considerable political risk. In the long run, however, increased imports at higher world market prices can place an ever-increasing burden on government expenditures.

Country Variations. As is the case for the developed countries, types of domestic policies used vary greatly from country to country. Brazil, Pakistan, Mexico, Egypt, and India sell grain at prices below free market levels, but Egypt and India also allow a parallel free market. South Korea and Taiwan are more concerned about price stability. For example, wheat imported into South Korea is sold at a government-established import price. If actual import prices exceed the government price, flour millers are subsidized. When actual import

prices are below the government price, millers are taxed.

Since rice is a particularly important food grain for developing countries, government price controls are common. Indonesia controls prices through government sales when retail prices exceed price ceilings by a specified amount. Many countries in Africa and the Middle East control rice prices. Easing price controls in recent years in some of these countries—Tunisia and Sri Lanka—led to considerable political problems for governments, including food riots.

Even countries with policies favorable to producers will frequently insulate consumers. Although rice prices paid by consumers in South Korea are above world market levels, they are not as high as producer prices. The South Korean Government sells rice at prices below those on the free market.

Domestic Policies Affect World Trade

Producer-oriented policies, as in developed countries, tend to lower world prices and increase their variability. Consumer-oriented policies, as in many developing countries, raise world market prices and also increase their variability. Countries with producer-oriented policies appear to dominate the wheat and coarse grains market. Rice prices in world markets are probably higher because consumer-biased policies in two major exporting countries — Thailand and Burma—and in African and Middle Eastern markets appear to have been more important than producer-oriented policies in the United States, Japan, South Korea, and Taiwan. Markets for soybeans are relatively free of such distortion. Support prices in two major exporting countries—the United States and Brazil—are set low enough that they rarely encourage surplus production. Although Asian countries have high price supports for soybeans, their production is small.

Whether the myriad of domestic policies has raised or lowered world prices is subject to debate, but these policies do inhibit domestic market adjustments to changing world market conditions, and thereby increase world price swings. Further, these policies clearly affect trade. Negotiation of trade barriers implicitly includes negotiation of domestic agricultural policies as well. That is why trade talks can get so prickly.