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# U.S. Farm Policy and International Agricultural Markets

by Daniel G. Amstutz\*

American agriculture has always been an industry subject to great uncertainties. Historically, these uncertainties were predominantly on the supply side, due to weather fluctuations, disease and pests. While these uncertainties continue, the uncertainties of international supply and markets have now become as great, or even greater, due to the increased importance of the international marketplace.

Until the late 1960's commercial international markets were almost insignificant for U.S. agricultural products. Farm legislation was primarily inward-looking reflecting the perspective of the agricultural sector itself. Farm programs were responsive to a domestically oriented clientele that had little interest or cause for concern with international markets.

During this period, the focus of U.S. international agricultural activities concentrated on collection of country by country statistics on area, yield, production and trade, low key market development efforts and disposing of U.S. surplus production into the world market through PL-480 programs and export subsidies. Domestic agricultural affairs and the international dimension were carried out in a separate, unrelated and generally uncoordinated fashion.

By the early 1970's this approach was no longer warranted or possible. As world markets exploded and domestic pressures on food markets grew, it became clear that domestic farm programs and international agricultural trade policies would require greater coordination if the United States was to lead the way toward worldwide agricultural trade liberalization. This recognition was slow in coming and its importance to further expansion of U.S. farm exports is not entirely accepted even today. For that reason, let us take a moment to review the changes that have taken place in the global agricultural and trade environment.

## A. *Historical Perspective*

World trade in agriculture rose 15 percent annually during the 1970's. Almost all exporting countries shared in this growth. American agricultural exports also increased, rising from 38 million metric tons in 1970 to 160 million metric tons in 1982. The high point of U.S. agricul-

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tural exports came in 1981 when 44 billion dollars was shipped overseas, an essential offset to the otherwise rapidly deteriorating balance of trade and current account.

During the period of rapid growth in the 970's, internal farm policies had little economic impact on international agricultural trade. It was not until the last three years, when world trade in agricultural products turned downward, that the relationship between domestic and international policies became clearly evident for the major trading countries. Europe and Japan particularly were forced to reexamine the relationship between their internal policies and their external trade conflicts. The United States, a long time advocate of greater market orientation in farm policies, began an accelerated effort of pressing vigorously in international fora for reform on international trade rules. At home the Administration maintained its position that free market competition offers the best way to achieve solid, sustainable, long-term growth for both the United States and other agricultural trading countries. To their credit, some of our trading partners have come to accept this position; others have not. Similarly, some of our domestic policy interest groups have recognized the issue's importance, and some have not.

A brief review of our own farm policies illustrates why we continue to press for freer world markets.

Prior to 1933, U.S. farm policy focused on developing our agricultural infrastructure to satisfy a growing internal market. Internal population expansion provided the opportunity for agricultural growth with a minimum of government outlay. Government support was resource oriented, aimed at land disbursal and increasing productivity. Agricultural commodities dominated the nation's exports during this early period even though they were relatively small. At late as 1900, farm exports accounted for three-fourths of total export sales but a relatively small percentage of total agricultural production.

The collapse of farm prices after World War I and the subsequent passage of the Agricultural Adjustment Act of 1933 marked a turning point for U.S. farm policy as the orientation changed from developmental programs to compensatory policies. Programs shifted toward encouraging higher productivity through the use of relatively high and rigid commodity price supports—the goal was to revive the prosperity of the 1910-14 period.

The early part of this second period saw increasing government involvement in agriculture, with commodity prices determined more by government policy than by market forces. The latter part of the period—from the end of World War II through 1960—brought a slow realization that satisfactory incomes for some farmers could not be provided by manipulating commodity prices alone. As a consequence, greater atten-

tion was given to community development, rural industrialization, improved education and regional development policies.

Throughout this 30-year period, agricultural trade policy was captive to an inward-looking domestic policy. Surpluses, generated by high price supports, led to a mounting interest in both domestic and foreign disposal programs. Trade restrictions under Section 22 of the Agricultural Adjustment Act of 1935 and voluntary import restraints sought to protect the established price levels.

A major turning point came in 1963 when wheat producers rejected a mandatory acreage control plan for wheat. The new policy tilt came to full flower with the passage of the Agriculture and Consumer Protection Act of 1973 with a shift to a deficiency payment scheme that provided target price payments to maintain farm income.

During this policy shift the United States went from high price supports and relatively tight controls on output, to greater reliance on the market as a determinant of commodity prices. Obvious exceptions remained, e.g., dairy, tobacco, sugar and peanuts. But for the major commodities, domestic farm programs were adjusted so as to facilitate rather than retard exports into international markets.

The real payoff came after 1972 when an unprecedented growth in the international agricultural market allowed the United States to increase its dominant position in the world market. Unfortunately, this ostensible "golden era" led many to conclude that there was no need to be concerned about coordination of domestic and international policies; and in 1981, a new farm bill reversed much of the change of the previous two decades. This coupled with other trends in the world market led exports to drop substantially after 1981. Policy analysts in turn were forced to take a new and urgent look at the changing trade environment and to reassess the policy mix that suddenly was not working.

Thus, U.S. farm policy has come through four distinct periods. During the earliest period, U.S. agriculture was open and accounted for most of the nation's modest foreign exchange earnings but had little impact on the international market.

The second period saw the United States turn inward, generating inflexible per-unit price support programs that resulted in large and expensive surpluses. During this period, only our newly begun PL 480 program kept agricultural exports growing, helping to relieve us of part of our burdensome surpluses.

The third period saw a policy shift that laid the foundation for the United States to enter and compete in the international market place without government export aid.

The latest period, characterized by unprecedented expansion and an increasing reliance on trade, followed by a turndown in our export for-

tunes, illustrates that internal farm policies can have a significant impact on our international trade prospects.

### *B. Components of U.S. Agricultural Policy*

Obviously, adjusting our price policies so that they better conform to rapidly changing market indicators is something that will materially impact on the rest of the world. Our actions affect other countries, perhaps more than their actions affect us.

Three characteristics of U.S. agriculture are of paramount importance in influencing the behavior of international markets. First is the sizable carryover stocks traditionally maintained by the United States that allow a rapid response to sudden market expansions. Second is an excess capacity in the physical agricultural plant that permits relatively rapid expansion of crop production. And third is a price umbrella effect established by crop loan rates that provides a stabilizing effect in world markets but often limits U.S. competitiveness. These reserve and price support programs have served for many years to cushion production and market fluctuations for the United States and the rest of the world.

By the same token, the United States, virtually alone among grain producers, has coupled its domestic support system with a requirement that producers reduce output when excess supplies exist. Unfortunately, experience indicates that the United States alone can no longer adjust excess supplies to world market needs. Most countries continue to increase output during surplus periods rather than cutting back production to slow the growth of surplus stocks. And many importing nations erect import barriers that thrust an even greater measure of price adjustment on market economies, particularly the United States.

Since the high point achieved for agricultural exports in 1981, trends have not been as favorable. The U.S. agricultural sector has suffered the effects of a substantial appreciation in the value of the dollar which hurt U.S. competitiveness in world markets. Moreover, until recently, negative Economic growth rates around the world have made repayment of past debts for many countries a crushing burden. Adding to this problem of past debt burdens has been rising real interest rates that make new financing even more onerous. The result has been a fall in U.S. farm exports, subsequent declines in prices and farm incomes and, given U.S. support programs and the high dollar value, a positive production response among our competitors. This production response results because U.S. support prices tend to set a floor for world market prices, which producers in other countries view as minimums. By using the U.S. umbrella, grain marketing boards in competitor countries can pay their farmers a higher local currency price for their commodities which gives their producers an incentive to expand production.

Thus, the United States is placed in the position where support and stocking policies, i.e., the farmer-owned reserve that insulates commodities from the world market, work to the disadvantage of U.S. farmers during periods of surplus world production. In short, the U.S. domestic price support program holds an umbrella over world prices, increasing foreign production while U.S. production is reduced through acreage reduction programs. Furthermore, rather than allowing the United States the typical position of a low cost price leader where others must adjust their sales to market needs after the price leader has marketed its supply, the United States is placed in a position of a residual supplier, and we can market our higher-priced goods only after other nations have exhausted their supplies. In short, our grain policies have operated to the substantial benefit of other exporting countries at the substantial expense of the U.S. agricultural budget.

### *C. Economics of Grain Trade*

The historical relationship between U.S. agricultural exports and our commodity loan rates is dependent upon a number of economic variables. Historically, the most important of these have been:

- 1) U.S. compared to prices of other sellers.
- 2) Real income and population changes in importing countries.
- 3) Supply availabilities in the United States and importing countries.
- 4) Market access as determined by importing country policies.

More recently in the 1980's, financial factors have taken on greater importance as importing countries have had liquidity problems associated with large debt service and the exchange rate for the U.S. dollar has soared to historic heights.

These variables are reflected in the patterns of growth of U.S. agricultural exports over the past several decades. Between 1940 and 1972, U.S. agricultural exports increased at a steady average rate of \$415 million per year in 1983 dollars. In 1973, primarily due to the entry of the USSR into the international market, U.S. exports jumped by about \$7.4 billion. And between 1973 and 1981, U.S. agricultural exports increased at an average annual rate of \$1.7 billion, four times the 1940-1972 rate.

This increase in the rate of export occurred for a number of reasons: growth in the world economy; and increase in world liquidity from the recycling of petrodollars; easy credit terms during most of the 1970's; a relatively low-valued U.S. dollar that made for inexpensive commodity prices; and production short falls in major consuming countries. The flexibility of U.S. agriculture to respond to these "demand shifters" by using large stocks on hand and bringing idle land quickly back into production allowed for an increased market share in a growing market.

The period of the 1980's has seen a reversal of many of these economic variables. The tight monetary policies adopted by the developed countries in response to the second oil price shock of 1979 plunged the world into recession and caused U.S. agricultural exports to drop approximately \$5 billion from 1981 levels. (See figure 1).

In addition to the overall downturn in world markets, the United States also lost market share. This was especially true for some crops where loan rates have a significant influence on market decisions. Wheat is a good example. The wheat loan rate strongly influences market price (see figure 2) thus leading to an unmarketable surplus when available supplies exceed demand at the loan price. With the exception of the early and late 1970's, the market price for wheat has closely paralleled the wheat loan rate. In these two periods strong demand raised the market price well above the loan rate.

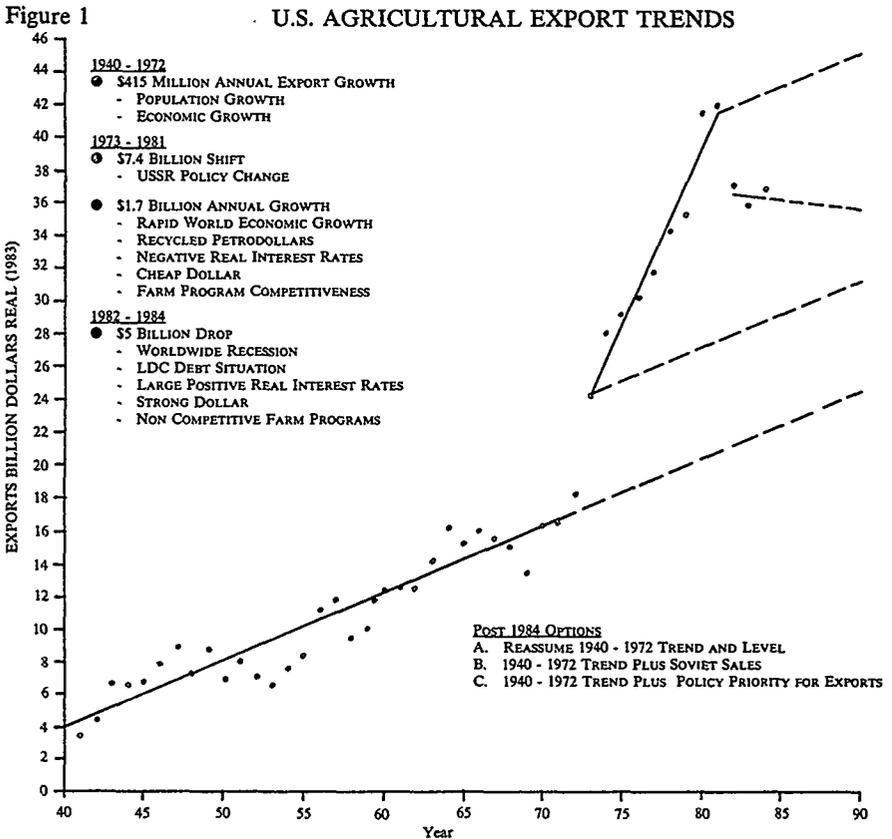
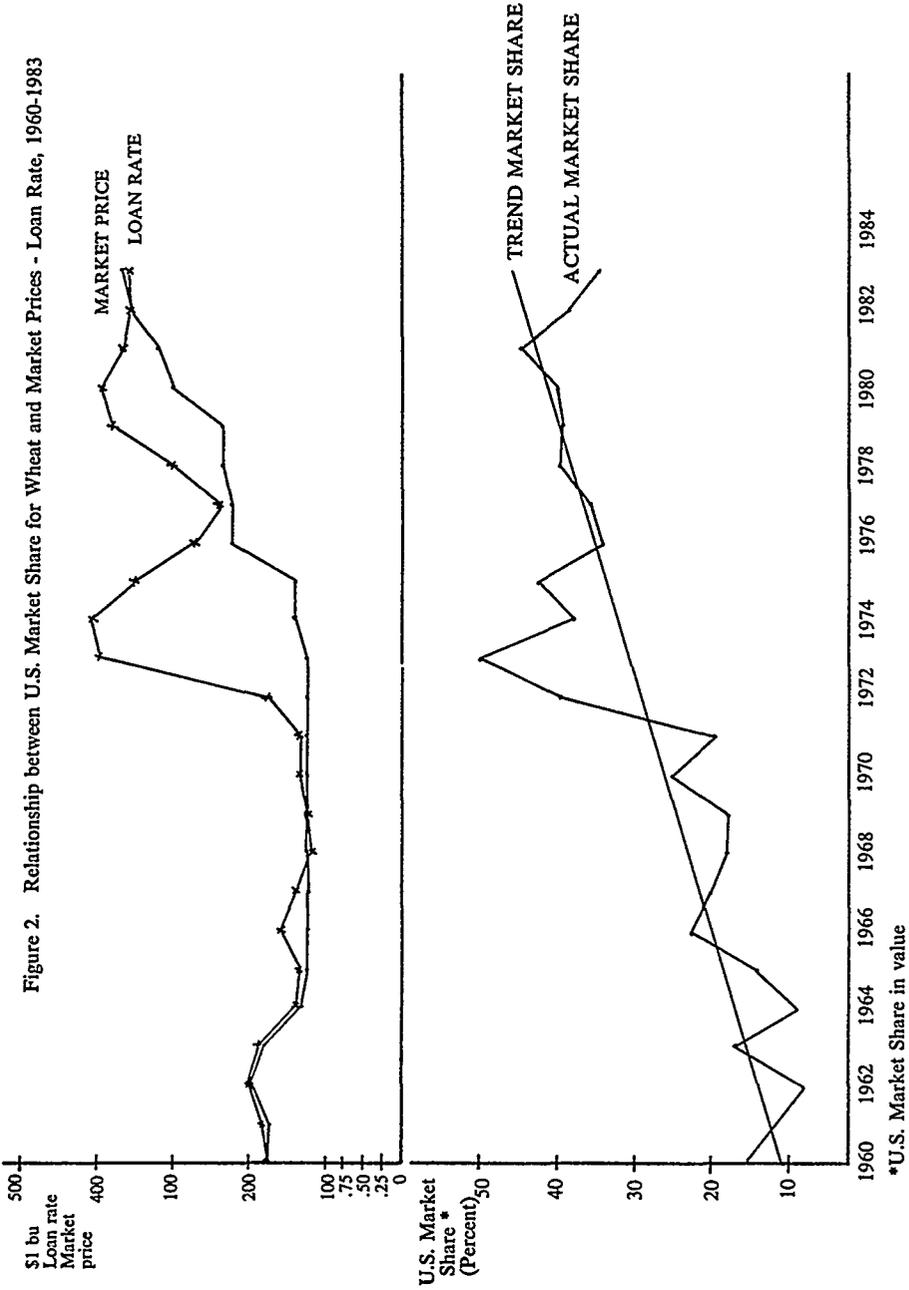


Figure 2. Relationship between U.S. Market Share for Wheat and Market Prices - Loan Rate, 1960-1983



\*U.S. Market Share in value

In these periods, U.S. market share (shown in the lower portion of the graph) generally rose. In years when the loan rate was the major price determinant, U.S. market share generally declined or was less than the average rate as determined by the trend line. The conclusion to be drawn is that in years when the loan rate is at a level sufficiently high to be a major price determinant, U.S. market share for wheat will decline or be less than average.

#### *D. The Economic Outlook for Trade*

At the end of 1984, parts of the world economy were in the beginning phase of economic recovery and growth. However, many developing countries, especially in Africa and Latin America, are still struggling with debt, domestic adjustment, and relatively weak trade and financial trends. The world economic growth rate in 1984 is expected to increase substantially from the sluggish pace of 1983. Growth in the U.S. economy is expected to outstrip the rate of other industrialized countries again in 1984, but by a somewhat smaller margin. Economic growth rates in Latin America, Africa, and the Middle East still lag behind other regions of the world, but a significant turnaround from 1983's negative growth rates is anticipated for these regions. Overall, the world economic growth rate was forecast to reach four percent in 1984, about double the 1983 rate.

Although the outlook for economic growth is improved, some weakness persists. Unemployment rates in many European countries continued to increase in 1984, despite the broadening recovery. In addition, foreign exchange shortages in many regions, particularly developing countries, are likely to continue, but may ease as increases in exports accompany the strengthening recovery. Problems of these countries will continue to preoccupy policy makers in the field of trade and finance.

The limitations of domestic policy in developing countries over previous years were clearly revealed by the unprecedented and unexpected global economic difficulties of the early 1980's. However, what turned a difficult situation into a crisis, especially for many of the middle-income developing countries, was a withdrawal of major commercial bank creditors from further lending. Without a replacement source of foreign capital, many of these heavily indebted countries were unable to service their debt fully and on a timely basis.

Decreases in agricultural imports by the high debt Less-Developed Countries were major contributors to the decrease in their total imports. For example, total U.S. agricultural exports to 17 major debtor countries dropped 20 percent (\$1.3 billion) between 1981 and 1983, while total U.S. exports to these countries decreased 40 percent (\$16 billion). Thus the decline in agricultural imports has been less in percentage terms than

the decline in other categories of imports. Declines in grain and oilseed exports accounted for a large proportion of this decline in U.S. agricultural exports to the major debtor countries. In a recent unpublished study by the U.S. Department of Treasury, the following conclusions were made:

1) Based on comparisons between 1981 and 1984 crop marketing years, grain and oilseed imports by rescheduling countries fell (by nine percent in volume terms); meanwhile, grain and oilseeds imports grew by 30 percent in other developing countries with less severe debt problems.

2) Imports by rescheduling developing countries of food (wheat, rice, soybean oil) were less affected (up ten percent) than were imports of feed stuffs (down 24 percent).

3) Mexico and Brazil played a large role in the statistics. A turnaround by them will affect the debtor country import totals significantly.

4) Eastern European countries with debt problems (Poland, Romania and Yugoslavia) also contributed to the decline in U.S. agricultural exports. Import volume of wheat for the three countries was down 19 percent, coarse grains down 78 percent, soybeans and products down 39 percent, and rice down 25 percent.

To keep exports growing, U.S. policies must take into account the special characteristics of foreign markets. Access to foreign markets for U.S. agricultural products is often restricted, and competition faced by U.S. exporters is often aided by other governments. U.S. policies and programs must take account of these factors as well.

In many developed countries the marketing of bulk commodities, especially grains, is often handled by government agencies or marketing boards. Import quotas and/or licensing are also used in the United States, Japan, Canada, and other countries. In Europe, widespread use of variable levies provide protection against imports when they are priced below domestic support prices. Developing countries also tend to have restrictive import regimes enforced by import licensing or, in the case of basic food crops, often directly controlled by state agencies. A few developing countries that can afford to do so provide incentives to agricultural exports as a means of earning foreign exchange. While few developing countries use direct export payments or provide credit for their products, they have sought to gain advantages through overvalued exchange rates, state trading, countertrade, and tax incentives.

#### *E. Impact of U.S. Policies on Other Countries*

If the U.S. loan rate has been successful in enhancing price for U.S. and other agricultural exporters, it will have increased price above what would have otherwise prevailed for the traditional importing countries. Such price enhancement has the dual effect of supporting these govern-

ments' efforts to increase prices and incomes for their own farmers at the expense of increasing food costs to consumers.

Perhaps the most important impact of U.S. policies on traditional importing countries is the security which U.S. farm programs offer. The United States alone has sufficiently large production and storage programs to insure the world's food supply. We recognize that storage is a costly budget item but a certain level of inventory is necessary for food security and trade. The objectionable part is the tendency for some countries to rely completely on U.S. storage and avoid paying a fair share of the carrying costs of their own food security.

Not only do U.S. storage and land reserve programs offer food security, they also serve to dampen price fluctuations arising from unusually large supply or demand changes. While it is true that price instability has been rising in recent years, the magnitude of these price swings would no doubt have been greater in the absence of U.S. farm programs.

The ability of the newly industrialized countries to rely on U.S. food supplies has been an important factor in allowing these countries to be more venturesome in their agricultural development programs and in allocating resources from food production to higher valued uses. The end result has been faster economic growth for the importing country and larger exports for the United States.

Another program that tends to stabilize food supplies for other countries is Public Law 480. Since 1954, PL 480 has caused over \$33 billion of U.S. farm commodities to be shipped to developing countries.

The issue always arises as to how much disincentive is created by U.S. food aid in a given recipient country. Obviously, prices to producers would be higher in the absence of food aid, all else constant. However, food aid agreements are only signed based on the conclusion of minimum disruption for local agriculture and the maintenance of usual purchases from commercial supplies. In addition, potential benefits to the overall economy may exist in the form of lower consumer food costs and hence lower inflation, as well as the use of commodity sales proceeds for economic development.

In fact, U.S. agricultural programs including PL 480 make important contributions to agricultural development in the poorest countries. We are the largest source of food aid. We provide food security because of our storage programs that permit us to respond to both emergency and non-emergency food needs. And we have the largest program of technical assistance. Although often overlooked, the use of foreign currency funds generated by the sale of PL 480 commodities sometimes represents the largest source of U.S. funding for programs to improve domestic agriculture in recipient countries.

In the livestock sector we typically have no direct price support policies; however, import restraints, when in effect, provide some domestic price enhancement. It is possible that these quotas have had a negative impact on some potential exporters in some years, although the effect is lessened by allowing the quota to increase as consumption increases. The world dairy market is highly government-managed, with all countries providing subsidies and import restraints. It is difficult to determine the impact of U.S. programs on others in such a setting.

Dairy prices are, however, seriously out of line relative to market realities due both to levels of support afforded the dairy sector and the structure of the support programs. A competitive dairy sector might well include a lower support level. The open market prices for manufacturing grade milk in periods of surplus may well be in the 6-7 dollars per hundred area.<sup>1</sup>

Several other commodity programs are worth mentioning. The sugar program provides price supports to sugarbeet and sugar cane producers. The current loan rate is 17.5 cents per pound for raw cane sugar, 20.86 cents per pound for refined beet sugar.

The international sugar market is a good example of the interdependence of national policies. In late 1980 and early 1981 the European community drastically increased its exports of sugar which caused the world price to fall. By Spring 1981 it was apparent that the world price would fall enough that the Secretary of Agriculture would be unable to insure the integrity of the sugar program and maintain legislated price support levels with existing authority to impose duties and fees on sugar imports. Thus quotas were imposed on imports to protect the operation of the legislated sugar program without major purchases of domestically produced sugar by the Commodity Credit Corporation (CCC).

Sugar and the sugar program represents a commodity in which substantial room exists for more market orientation. However, there must be greater recognition of the international interrelationships and less market interference by exporting countries which subsidize their exports of sugar before the United States can achieve the goal of adjustment to world market prices.

The honey and rice programs are other examples where domestic

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<sup>1</sup> The Dairy and Tobacco Adjustment Act of 1983 amended the 1949 Agricultural Act to establish the 1983/84 dairy support level at \$12.60 per hundredweight effective December 1, 1983. The \$12.60 support price will be effective thru September 30, 1985. However, USDA may reduce the support price on April 1, 1985, if it estimates that net purchases of milk and milk products by CCC are 6 billion pounds milk equivalent in the succeeding 12 months. On July 1, 1985, the support price can be reduced an additional 50 cents per hundredweight if it is estimated that net purchases will exceed 5 billion pounds milk equivalent in the next 12 months. The new law also requires that effective 12/1/83-3/1/85 USDA deduct 50 cents for marketing marketed in the 48 states. Funds collected from these marketings will be used to partially offset the cost of the program.

programs have limited our international competitiveness. The national average support price for 1984 crop honey was 65.8 cents per pound, up 3.6 cents from 1983. The program provides market stability to honey producers and encourages maintenance of bee populations that are vital for pollination of important seed fruit and vegetable crops. Nevertheless, at the level of support, the CCC was in the position in 1984 to purchase up to 50 thousand metric tons of the domestic honey crop while 40 percent of U.S. consumer demand is satisfied by imported honey. The 1984 rice program called for a national average loan rate of \$8 per hundred-weight (CWT) and a target price of \$11.90 per CWT. At these prices U.S. rice has been undersold by rice from Thailand by \$120 per ton to Mexico, right at our back door.

A final example is the tobacco program. While the tobacco programs are presently operating through producer assessments with no net cost to taxpayers, tobacco prices have been stabilized and marketing quotas established at levels that resulted in 232 million pounds of burley valued at \$567 million under government loan on September 30, 1983, and 676 million pounds of flue cured valued at \$1.27 billion under government loan on July 1, 1983. This is up from 0.6 million pounds of burley and 531 million pounds of flue-cured tobacco under government loan the previous year.

Not only has growth in our exports of tobacco almost stopped, but producers have asked the government to protect them from lower cost import competition. An important point that is often missed is that export sales of tobacco products, mainly cigarettes, are still strong.

These several programs where government of directives have replaced market signals provide substantial opportunity in coming years for more market orientation. We accept that such change is difficult and can only be accomplished if the resulting social disruptions are dealt with meaningfully. But the necessity is to move toward greater competitiveness and to reduce pressures for import restrictions or export subsidies.

#### *F. Domestic Farm Policy Options*

The farm policy options available to enhance the U.S. competitive position internationally include: (1) commodity specific adjustments where changes in support levels over the last several years have pushed the prices of a product out of line with overall market conditions; and (2) adjustments in overall price levels for program commodities to compensate for the general upward drift in support prices. Some type of revision of current programs will be necessary to maximize the long-run competitive position of the United States, particularly in wheat, rice and dairy products. The restructuring of U.S. farm programs involved would also

work to make continuation of current European Community farm and trade policies increasingly expensive.

Future U.S. agricultural programs could have a potential detrimental impact on the less developed countries and the United States as well if we allow ourselves to succumb to protectionism.

We have always advocated a free trade position as befits the world's largest agricultural exporter. This philosophy is even more important today when many of our best potential customers are hard pressed to meet debt obligations. If we diminish export opportunities for these countries, it not only creates greater debt servicing problems for them but virtually guarantees they will not be able to earn foreign exchange to buy our products.

We need always to be mindful that protecting one small product in this country, whether agricultural or industrial, imposes lost export opportunities for all of U.S. agriculture. This administration has strongly resisted these pressures. We must continue to lead the way in insuring that our agricultural programs move toward free trade for the greater benefit of U.S. agriculture and the rest of the world.

