



December 1999

The Main Street --- Economist

Commentary on the rural economy



What's at Stake for U.S. Agriculture in a Global Trade Deal?

*Kendall McDaniel
Associate Economist
Center for the Study of Rural America*



Trade ministers from around the world gathered in Seattle November 30 through December 4 to launch a new round of global trade negotiations. Their objective was to set an agenda for broadening world trade, creating new opportunities for producers, and cutting costs for consumers. Trade in many industries was on the table, with agriculture a key focal point.

While agreement on launching the new trade round proved elusive in Seattle, the world community is still rethinking how to improve world trade. U.S. agriculture has much at stake in these deliberations. Much of the industry's bounty is shipped abroad, though the industry's foreign sales have a boom and bust history. A new global trade agreement may not end the ebb and flow of U.S. farm exports, but it can broaden access to world markets and build a healthier global economy, which underpins the industry's foreign sales.

Trade is vital to U.S. agriculture

Unfettered trade in a healthy global economy remains vitally important to U.S. agriculture. Each year nearly a fourth of the industry's production—including roughly a third of the nation's crop production and a tenth of its livestock production—is destined for foreign markets. Farm exports rose steadily in the first half of the decade to a crest of \$60 billion in fiscal 1996. But then the industry's foreign sales tumbled to \$49 billion in 1999 in the wake of the financial problems in Asia and other important markets. The farm export slump drove down farm commodity prices, again underscoring the industry's reliance on foreign markets.

Looking ahead, demand for agricultural exports should strengthen as populations grow and incomes rise, especially in developing countries. Current projections show that by 2010 more than 80 percent of the world's people will live in Asia, Africa, and Latin America. And rising incomes in these parts of the world should enable more people to spend more money on food than ever before. During most of the 1990s, growth in developing economies was more than double the pace in the richer developed nations. Although many developing economies have stumbled in recent years, most indicators suggest these countries are bouncing back.

This combination of rapid growth in populations and incomes is a potent recipe for boosting world food demand. By tearing down the roadblocks that still impede the flow of food around the globe and sustaining income gains in the developing world, a global trade agreement could enhance prospects for U.S. agriculture's foreign sales.

Agricultural issues topped the Seattle agenda

The Seattle meeting brought together the 135 members of the World Trade Organization (WTO), which governs international trade rules and provides a mechanism for settling trade disputes. Its member-nations account for 90 percent of world trade and the bulk of the world's population. On the table was trade in sectors ranging from services to telecommunications and electronic commerce. But existing trade policies in many of these countries continue to make agriculture one of the most highly protected industries in the world. As a result, agricultural trade was a key focal point in Seattle and will probably remain at the top of the agenda when trade talks resume.

In eight previous rounds of international trade negotiations dating back to

Tariffs and quotas hinder market access

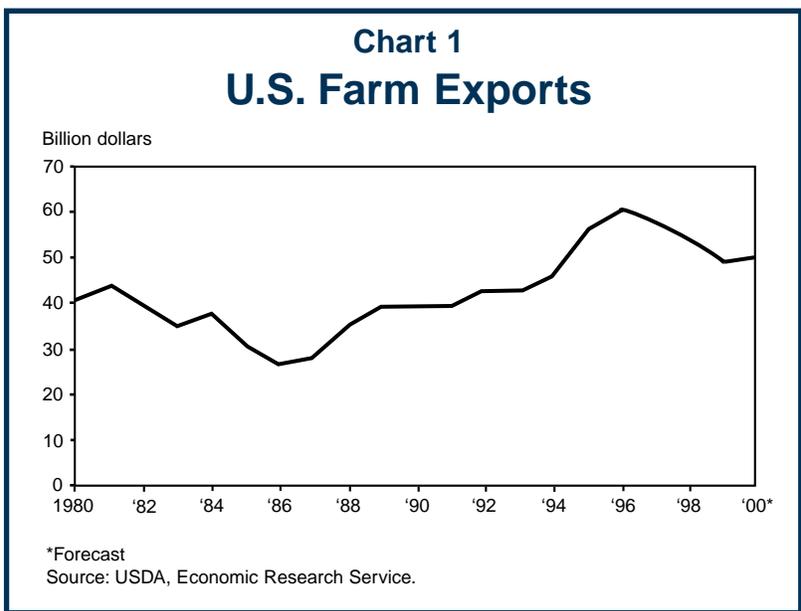
Two trade barriers, tariffs and quotas, significantly hinder global sales of farm products. A tariff is a tax on imports, while a quota limits the quantity of agricultural products flowing into a country. Both tariffs and quotas protect the importing country's producers from foreign competition while raising prices for its consumers.

The Uruguay Round attempted to improve market access by eliminating quotas and converting to tariffs all other trade barriers that limit imports. Recognizing that imports could be restricted by high tariffs and that some countries rely on a small number of agricultural products, the Uruguay Round created tariff-rate quotas. A tariff-rate quota is a combination of a quota and a tariff that sets relatively low

tariffs on imports up to a certain level, but raises the tariff rates for additional imports above that level. Such a policy, it was hoped, would maintain historical trade levels and open all markets to some competition from abroad.

Success of the Uruguay Round was limited, though, as some countries set very high tariffs or found other artful ways of circumventing the Uruguay Round commitments. Many countries imposed low tariffs on imported products not also

produced domestically, while setting high tariffs on imports that competed directly with domestically produced goods. Other countries discriminated against individual countries when allocating quotas under tariff-rate quotas. The challenge ahead is to build on the limited success of the Uruguay Round, by further reducing tariffs and lifting quotas and by tightening the rules on market access commitments.



World War II, talks centered mainly on manufactured goods. Tariffs on these internationally traded goods were trimmed to an average of just 4 percent. Only the most recent trade talks—namely the Uruguay Round—targeted trade policies in agriculture, where tariffs still average about 40 percent. Four key issues remain in agricultural trade: market access, farm support policies, export subsidies, and product regulations.

Farm support programs encourage excess production

Another key challenge is to reduce farm support programs. Support programs subsidize domestic production in many countries, causing surpluses that push down world market prices. And where world prices are down, governments are encouraged to further subsidize their producers in an expensive cycle. On the agenda for reform are farm support programs in three areas previously identified in the Uruguay Round: amber box, blue box, and green box policies.

Amber-box policies significantly distort global production and trade, and so the Uruguay Round restricted their use. Amber-box policies boost farm incomes by subsidizing the prices paid or received by farmers, encouraging excess production that is often shoved onto the world market at discount prices. Examples of amber-box policies in the U.S. and EU include dairy, sugar, and beef price support programs, subsidized insurance premiums, commodity loan interest subsidies, and storage payments.

The impact of amber-box policies can be gauged by a numerical index called the aggregate measure of support (AMS), which enables the WTO to compare these policies with an eye toward winding them down. Nearly 90 percent of the world's AMS in 1995 was concentrated in the European Union, U.S., and Japan.

Blue-box policies are less harmful to world trade than amber-box policies. Like amber-box policies, blue-box policies subsidize farm incomes, which can encourage price-depressing surpluses in future years. But blue-box policies reduce the potential for building up excess supplies by also requiring farmers to limit production. For example, deficiency payments in the U.S. and compensatory payments in the EU both make payments to producers based on fixed or historical production and then limit production countrywide with acreage reduction programs.

Prior to 1996, U.S. farmers could receive a deficiency payment that made up

the difference between the market price for some crops and a higher target price. This price subsidy, however, was combined with limits on the number of acres that farmers could plant, holding down excess production the price subsidy might otherwise encourage. A new U.S. farm policy enacted in 1996 changed the deficiency payments to "market transition payments" that are fixed in amount and not affected by the level of production. These new payments are included in the green box.

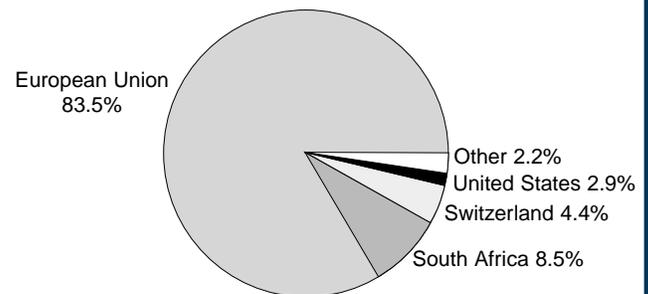
Green-box policies have the least effect on production and trade and thus have been permitted by the WTO. Green-box policies include programs such as domestic food aid, research, inspection, natural disaster relief, crop insurance, environmental programs, rural assistance, and farm income support payments (like the U.S. market transition payments) that are "decoupled" or not tied to the level of production. As long as policies do not distort production decisions and thus world trade, they are likely to be included in the green box and allowed by trade negotiators.

The U.S. objective stated at the Seattle meeting was to further establish a fair and market-based trade system by winding down trade distorting farm support policies. Useful approaches include improving the calculation of AMS indices and trimming amber-box policies, eliminating blue-box policies or requiring them to be transformed into less harmful green-box policies, and tightening the definition of green-box policies.

Export subsidies dump supplies on world markets

A third important farm-trade challenge

Chart 2
Share of World
Export Subsidies
1996



Source: USDA, Economic Research Service.

is the elimination of export subsidies. Many countries aim to boost incomes for domestic producers by paying them a subsidy as their products leave the country. Like domestic support programs, export subsidies encourage excess production and push down world prices. As a result, incomes for domestic producers rise and incomes for foreign producers fall.

Currently, the use of export subsidies is concentrated in just a few countries, but their impact on world markets is still a problem. In 1996, the European Union was the largest user of export subsidies, accounting for 84 percent of the world's total (Chart 2). The United States was fourth, due mainly to the dairy support program. Many countries, including the United States, have already proposed to eliminate export subsidies.

Product regulations can conceal trade barriers

The final farm-trade challenge is perhaps the most difficult one. In recent years, many countries have limited or banned imports of various goods, citing concerns over food safety or plant and animal health standards. Food safety and health standards are legitimate concerns that can be addressed by various regulations, including product standards and

testing, labeling requirements, or bans on unacceptable imports. When product regulations are applied arbitrarily or without a sound scientific base, however, they become thinly disguised trade barriers.

To address such unfair product regulations, the Uruguay Round created agreements on Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT). SPS measures allow countries to set their own standards regarding plant, animal, and human health. These standards must be based on science and cannot discriminate against individual countries. Similarly, the TBT agreement ensures that regulations, standards, testing, and labeling requirements do not create artificial barriers to trade.

Perhaps the most notable case where product regulations were used to discriminate against imports was the EU's ban on U.S. beef produced using growth hormones. The EU cited a potential health risk for European consumers. The United States objected and asked the WTO to settle the dispute. Last summer the WTO ruled the EU ban was based on unscientific regulations, and the U.S. was allowed to impose trade sanctions on the EU to recoup an estimated loss of \$117 million in beef exports.

Although U.S. agriculture won a major victory in the EU beef case, regulations on genetically modified organisms (GMOs) still present significant stumbling blocks to trade in several foreign markets. The European Union, Japan, and others have enacted policies that either ban genetically modified crops or require products made from them to be labeled in certain ways. Such policies have a huge effect on U.S. producers, since about 44 percent of U.S. soybeans and 36 percent of U.S. corn are grown with genetically modified seeds.

The global leadership of U.S. companies in developing GMO products and their growing use by U.S. farmers makes stricter guidelines for product regulations a critical negotiating point in trade talks. Unless future trade agreements can strengthen the scientific basis required for

such regulations, exports from the United States and other countries could be hurt, producer costs could rise, and consumers around the world could be denied access to valuable new products.

Conclusions

The Seattle meeting of the WTO placed agriculture at the top of its agenda, promising to address fundamental flaws that continue to hamper the flow of farm products around the globe. While the Seattle meeting failed in its ambitious agenda to launch a new round of global trade talks, agricultural trade will remain a key focal point of future trade negotiations.

U.S. agriculture has much at stake in the future course of world trade. With nearly a fourth of its output shipped abroad each year, the industry is heavily reliant on the world's trading system. A recent slump in farm exports triggered a downturn in the U.S. farm economy and reminded the industry of the up and down nature of its foreign sales. But export prospects are beginning to improve again, as economic recovery takes root in Asia and other important markets.

Unfettered trade promises a further expansion in the global economy, as producers from the United States and other countries gain freer access to world markets and consumers gain access to products from other lands. As global incomes rise, food demand grows—especially in the developing countries that are U.S. agriculture's most promising customers. While the ebb and flow of U.S. farm exports is likely to continue in the years ahead, further trade reform is the industry's best bet to strengthen the foundation underpinning its foreign sales.

The Center for the Study of Rural America will track the shifting currents in the rural economy each month in *The Main Street Economist*. In-depth studies of major rural economic and policy issues will appear in the Federal Reserve Bank of Kansas City's *Economic Review* and other publications. Next spring, we will launch a new national conference on rural issues.

Center Staff

Mark Drabenstott
Vice President & Director
mark.r.drabenstott@kc.frb.org

Alan Barkema
Vice President & Economist
alan.d.barkema@kc.frb.org

Kendall McDaniel
Associate Economist
kendall.l.mcdaniel@kc.frb.org

Kristin Mitchell
Research Associate
kristin.m.mitchell@kc.frb.org

Nancy Novack
Research Associate
nancy.l.novack@kc.frb.org

www.kc.frb.org