Commentary on 'Enhancing Competitiveness: International Economic Policies"

D. Gale Johnson

Given the time limits imposed on me, I do not have time to treat Mr. Avery's paper as politely as one should treat a guest. So I apologize to Mr. Avery at the start for some comments and criticisms that may appear a little sharp in order to make a point in a brief amount of time.

Mr. Avery has some rather harsh things to say about export subsidies, especially when used by the United States. Referring to U.S. export subsidies he asks these rhetorical questions:

"Who benefits therefore from this kind of measure? And who pays?" But what about European Community export subsidies, which have involved the following amounts in European Units of Account (EUAs):

1979	**6.44** billion
1980	**7.60** billion
1981	**5.50** billion
,1982	**4.70** billion
1983	**5.10** billion
1984	**5.30** billion

Yet the EC is concerned about a curiously administered $2 billion fund to be expended over a three-year period. This fund is now tied up with a cargo preference ruling issued by a federal judge. Has the EC ever considered that its use of export subsidies could go unchallenged forever?

Mr. Avery discusses U.S. dairy policy and U.S. export subsidies, claiming that the United States captured a large share of the export market for one dairy product—dry skim milk and that for one year, **1982.** Let us look at what has happened to world dairy exports since the beginning of the **1970s.**

Essentially all dairy products exported from the EC have been subsidized for the past 15 years. It is thus interesting to compare what changes have taken place in world dairy trade since 1969–70. The net exports of four leading dairy producers were as follows for the years indicated (whole milk equivalent in tons):

	1969–70	1982
European Community	Zero net exports	17.0 million
Australia	3.1 million	1.3 million
New Zealand	6.2 million	6.3 million
United States	-1.0 million	1.8 million

One might ask, as does Mr. Avery, why the world market suffers from gross oversupply of dairy products? The data seem quite clear on this point. Only one of the four major dairy producers substantially increased dairy exports. One low-cost producer—Australia—actually decreased exports and the world's lowest cost producer of dairy products—New Zealand—was able only to hold its absolute level of exports constant but lost market share in world dairy trade.

I found much of his discussion of the position that EC will take into GATT negotiations either very vague or very disturbing. These positions are enunciated:

- EC will maintain its position for import and export of agricultural products. Does this mean the status quo is to be maintained with the EC as an exporter of grain and the world's largest exporter of dairy products, beef, and sugar?

- EC will retain a system of variable import duties and export refunds (subsidies) to stabilize its internal markets. He says this does not preclude improvements in the system. But what improvements would be considered? Basing threshold prices on some relation to world market prices of past three years? Or a stated reduction in target prices—say 2 percent per year—until some relationship to world prices is reached? It is not clear what improvements are envisaged.

I find quite disturbing the comment that the EC will retain variable levies and subsidies because they 'paid with concessions in earlier negotiations for the right to apply these mechanisms." What was paid? Actually what was paid was the binding of tariff duties on what were then considered to be insignificant feed products. But the EC has become increasingly unwilling to live up to these commitments. It has already "weaseled" its way out of its binding on manioc flour by negotiating agreements with weaker trading partners to limit their export to the EC. It has tried to tax vegetable oils, though not butter, which the EC produces in large quantities.

The EC has heavily subsidized farm products that compete with soybeans and other similar products. As Mr. Avery notes, such subsidies, called production aids or deficiency payments—for olive oil, oilseeds, butter, skimmed milk powder for animal feed, and certain processed fruits and vegetables—have been paid for several years. Is it possible by those means largely to negate the "price EC paid for its variable levies and subsidies?" Is it intended to continue with these policies in the EC? Mr. Avery is not clear. Such policies will almost certainly further reduce EC imports of agricultural products.

And, in any case, even if the EC paid a lot, is this a good argument for continuing a policy of variable levies and export subsidies that may be counterproductive?

The main hope for the future concerning EC policies is the statement: "In the longer term, the support prices fixed by EC could be fixed at levels closer to those of other exporting countries." However, you should not let your enthusiasm run wild—note the qualification, "this would be logical especially for those producers where the world market accounts for a significant part of EC production." Does this mean that maize or corn would be excluded since EC is not now an exporter? Or that oilseed support would continue to increase because the EC is a large importer of oilseed and vegetable meals and oils? It is not clear exactly what is intended.

But this is enough about particular policy measures in the EC. I will close by commenting about the very serious problem the EC and U.S. agricultural policies have created. Neither Mr. Avery nor Mr. Amstutz gave adequate consideration to some of the long-run problems our agricultures face.

We have created a substantial excess productive capacity in agriculture that will haunt us for most of the rest of this century. Even if appropriate policies started tomorrow, it would take the EC and the United States nearly a decade to eliminate this excess capacity and return to a situation in which market prices would provide adequate incentives for a renewal of slow output growth.

If we continue with the kind of policies that seem implied by EC discussions and the farm legislation now under discussion in Washington, we will be haunted by large expenditures, competitive export subsidies, and increasing tensions between us. What needs to be recognized in both the EC and the United States is that our policies have been responsible for depressing world market prices for most farm products. The declines range from 15 to 25 percent for wheat, 10 to 15 percent for coarse grains, by as much as 50 percent for dairy products, a quarter for beef and, currently, by 70 to 75 percent for sugar. While the available empirical estimates attribute greater responsibility to the EC than to the United States for this state of affairs, U.S. responsibility is probably greater than these studies indicate. No study has adequately modeled the effects of our target prices on grain and cotton production and it has not beer, possible to reflect adequately the impact of our current sugar policy on world demand for beet and cane sugar.

Two final points. First, we may not have seen the end of the decline in rate of growth in international trade. All of the projections I am familiar with project Chinese grain imports at or above the levels of the early 1980s. However, the Chinese economic reforms are working. China is unlikely to be a net importer of grain by the end of this decade. But even with Chinese grain imports continuing at recent levels and East European grain imports at the 1980 level, the projections of world exports of agricultural products are projected to grow from 1980 to 2000 at only half the growth rate of the 1970s. But East European grain imports are now only half what they were only five years ago. And it is unreasonable to expect further large increases in agricultural imports by the USSR.

Second, one can only hope and pray that the EC and the United States, along with Canada and Australia, can recognize the seriousness of the situation that they and their farmers face for the rest of this century. This will require the EC to take a much less defensive attitude toward the CAP, to recognize emotionally and intellectually the impact that the CAP has had on the level and stability of international market prices, and to be willing to seek alternative ways of meeting the income needs of the less developed areas of the EC.

The United States must face up to its failures to follow a liberal trade policy in agriculture and a market-oriented policy domestically. We have to give up the 1955 GATT waiver. We should abolish our quantitative import restrictions for beef, sugar, long staple cotton, and dairy products. We need to recognize that our deficiency payments are first of all a subsidy and indirectly are an export subsidy. Except for our efforts to do something about our dairy output—though at best I think our intention is only to reach self-sufficiency—we have done not one thing since 1981 or since 1977 to make our domestic farm policies consistent with a liberal trade policy.

I agree that some of the decline in U.S. exports of agricultural products since 1981 has been due to the overvalued dollar, our high price supports, EC export subsidies, and the response of some of our competitors to U.S. output restraints, such as those that existed in 1982. But to expect that a declining value of the dollar and a sharp reduction in our price supports will result in our quickly regaining the 1981 value of agricultural exports is being wildly optimistic. I hope I have made it clear that the situation U.S. and EC agriculture now face cannot be corrected by merely tinkering with a few policy measures or currency realignment. We can produce more agricultural products than can find markets at prices that will provide a reasonable return for the resources now engaged in agriculture. Just as we did in the late 1950s and through most of the 1960s, the United States faces a long period of difficult adjustments in agriculture. It is necessary to reduce the resources engaged in agriculture. This means the reduction of labor and capital since most of the land will remain in agricultural use.

The adjustments that would be required of U.S. agriculture would be significantly less painful if similar adjustments were underway at the same time in the EC as well as in Japan. Hopefully, the forthcoming round of GATT negotiations will make some progress on this score. Unfortunately, I am dubious about the willingness of either the EC or the United States to face up to the realities of world agriculture and the need to adjust their farm policies. Thus, I am quite pessimistic about the prospects for any real change before the end of this decade.