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AGRICULTURAL TRADE AMONG FRIENDS: THE PARLOUS STATE OF U.S. TRADE RELATIONSHIPS WITH THE INDUSTRIALIZED WEST

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Introduction

Agricultural trade seems not to stimulate friendship among countries. One partner or the other is almost certain to be dissatisfied with the level and conditions of such trade. Relationships among the group of Western industrial democracies exemplify this problem. Agricultural issues cause tensions out of all proportion to their absolute importance in the Western alliance and their relative significance to trade and employment. Since both friendship and agricultural trade among countries are beneficial, and since the problem seems destined to spread to emerging industrial countries, a better understanding of the issues is in order. If the problem has grown out of proportion in recent years, a solution is correspondingly more necessary now than in the past.

This paper outlines the changing nature of agricultural trade relationships between the U.S. on the one hand and the European Community (EC), Japan, Canada and Australasia on the other. One part of the problem lies with the development of farm policy in the various countries, and this will be discussed at some length. But other factors interact with these policy developments, in particular macroeconomic forces and changes in non-farm trade policy. Since the particular manifestation of the problem differs by country and commodity, some mention must be made of these differences. These issues, by their nature, are likely to be with us for some time to come. Nevertheless, some ideas are offered for a relaxation of tensions and a constructive attempt at cooperation to solve mutual trade problems.

The Anatomy of the Agricultural Trade Problem

The underlying problem bedeviling agricultural trade relationships among countries at a similar level of development can be traced to the heavy involvement of governments in their domestic agricultural sectors. Though this problem is not unique to agriculture (the steel industry provides an example of a similar conflict) it has perhaps reached its peak in this sector. Ironically, the agricultural industry in most industrial countries is one of the most competitive. Despite some growth in corporate enterprises, the agricultural sector is characterized by small independent units making individual decisions based on local conditions. The government stands back from the production process but takes charge of market conditions, at least for the major crops and livestock products, thereby hoping to create a favorable environment in which the farmer can make a respectable living.

The size of this market can be manipulated through a variety of strategies including state purchasing, the discouragement of overseas supplies, the subsidization of exports and the granting of aids for domestic use. The role of the government in such activities immediately conflicts with the interests of other governments similarly engaged. State buying if not simply for intra-seasonal supply smoothing, leads to disposal on other markets. Import restrictions are seen by foreign governments as hindering their own market objectives. Consumer subsidies usually involve trade restrictions if domestic farmers are to gain. In short, unless by chance the favored commodities differ by country, domestic policies geared to enhancing income opportunities for domestic farmers immediately run afoul of those of other countries.

This proposition can be put more formally in the following way: Domestic producers face a demand for their produce which is a composite of domestic demand and foreign demand for an exporter, and domestic demand and foreign supply in the case of an importing country. A large harvest (or an increase in output from a livestock sector) would depress local prices to the extent that the export market could not absorb the excess at the same price, or that imports could not readily be displaced. Farm policy, at best in its protective or defensive manifestation, aims at raising demand--to provide higher returns, and at making it absorb more output fluctuations without changes in price--to add market stability. This "higher and flatter" demand of the farm sector meets domestic needs, but has implications for other countries. The additional demand, unless achieved by consumer or user subsidies, necessarily lowers the demand faced by other producers in the same trading system. The stabilizing of price just as certainly makes the demand faced by

farmers in other countries less stable. This "lower and steeper" demand contradicts policy objectives in other countries, making policy less effective, or the same effect more costly. It is this struggle for profitability and stability, at the expense of other countries, that characterizes farm trade disputes.

The Actors in the Trade Policy Arena

In view of this seeming incompatibility between trade and domestic policy, it is surprising that so much trade in farm products exists among industrial countries, and that farm policy conflicts are not more widespread. This is perhaps backhanded testimony to the ineffectiveness of domestic farm policies, and to the success of pro-trade interests in curbing or circumventing the autarkic tendencies of agricultural ministries. First and foremost, the food and feed industries, more concerned with low cost and high quality than country of origin for their raw materials, have shown an impressive facility for searching out foreign sources of supply. They have forced agricultural interests to play "catch-up," taking advantage of new trade opportunities until they become an embarrassment to domestic farm policy. Secondly, livestock farmers, often burdened by the need to buy high cost domestic feeds, have shown a willingness to take advantage of the natural cost advantages of large-scale arable farming in the plains of North and South America and Australia in reducing their feed costs. Domestic pig and poultry industries, encouraged by their compound suppliers, have located near population centers and practiced their skills in transforming plant material into high quality consumer foods. This internal specialization within agriculture is again a force for trade expansion and an embarrassment to the market managers in agricultural ministries.

In addition to the increasingly international food industry and the livestock farms and their suppliers, a third group of interests, potentially of much greater significance, points in the direction of trade. Consumers are the ultimate beneficiaries of the international division of labor, both in agriculture and in other products. They can only be advantaged by a widening of choice among competing suppliers. Even consumers in exporting countries gain indirectly as the foreign exchange earnings enable importation of non-farm goods. This particular pro-trade force is, however, muted by government policy as well as by a general lack of political organization among consumers qua consumers. They are in many cases kept in blissful ignorance of the opportunities which are being denied them. To avoid excessive tax burdens, governments load much of the cost of farm support onto the household food bill. To encourage consumers to compare prices across countries (as they do among supermarkets) would be to invite dissent and weaken the basis for farm

programs. Instead, the consumer is fed a diet of stories of unreliable world suppliers and taught the virtues of self-sufficiency. Various giveaway programs are tacked onto farm support legislation to encourage urban support for what are basically anti-consumer policies. One day, perhaps, consumers will question their role in the farm policy process, but until that time comes, they will continue to pay dearly for marginal improvements in security of supplies.

Two more groups make up the cast of characters. Industrialists from other sectors have an interest both in agricultural trade itself, as it affects foreign exchange earnings and living costs, and in the politics of such trade, as they impinge upon other areas of commercial policy. One would expect, for instance, export-oriented manufacturers to favor import liberalization in agricultural markets; industrialists seeking protection against imports may have more positive feelings about the support of agricultural protection. Many businesses in other walks of life, however, have a tendency to avoid discussion of agriculture, perhaps from a fear that the complexities of support policies would make their own interventions seem naive or to avoid weakening their own industry-specific arguments. Similarly, trade departments and commerce ministries have been led to believe over the years that only agricultural experts can discuss or negotiate on farm trade issues.

Less retiring is a final interest group, almost as ubiquitous as consumers but much more articulate. Taxpayers, supported by finance ministers, have established a direct interest in the farm trade debate. Though such an interest does not always coincide with trade liberalization--import taxes, for instance, benefit the taxpayer--it runs generally in the direction of the scaling-down of price supports. Budget pressures today dominate agricultural policy-making as rarely before; if the taxpayer is not king, he is an important adviser and trenchant critic. Yet it is the very willingness of the consumer to absorb unflinchingly more of the farm support burden that serves to weaken the fiscal control over policy.

The Changing Nature of Agricultural Trade Issues

Before fleshing-out this anatomy with details as to country and commodity, it is interesting to observe the conditions under which the debate will be most intense and the situations which are likely to ease tensions. One could easily sketch out a "worst-case" scenario for agricultural trade problems. Imagine a situation where the exporting countries faced problems in their overseas markets caused by slow income growth, historically high exchange rates vis à vis the importers' currencies, and high support prices in those importing countries. Add to that a weak domestic

off-farm employment situation (and perhaps some pressure from forthcoming elections) and one has a recipe for heightened agricultural trade problems as seen by the exporter. This will translate into additional pressures for trade liberalization by the importing countries. If those countries in turn have, as a result of budget pressures or low farm incomes, been trying to expand the markets for their own producers, this additional external pressure will trigger a defensive reaction which could have long-run consequences. The revival of economic growth, at home and abroad, may remove some of the problem for the exporter; the importer may find it more difficult to reverse the rhetoric and "deprotect" the domestic agricultural industry.

The present situation seems to correspond to this dismal scenario. The highly valued dollar, due largely to the decision to finance budget deficits by offering attractive debt instruments rather than by increasing taxes--thus shifting foreign demand away from wheat and corn towards treasury bills--has hit U.S. farm exports at a time when economic growth in other countries is still sluggish. Price levels in importing countries have followed their own path, dictated by domestic events, rather than reflecting the generally lower real prices on world markets. Persistently high interest rates hamper a now capital-intensive U.S. agriculture, and exacerbate the burden of the budget deficit. Firms are reluctant to take on new workers, thus limiting the off-farm opportunities for rural workers. Protectionist sentiments abound in many sectors of the economy, making it more difficult to espouse a credible foreign commercial policy of liberalization. As a result, agricultural trade disputes seem further from resolution than for many years.

If these events were merely a temporary phenomenon, born of the 1981-82 "Great Recession," then one might be tempted to look past them to a normalization of trade relations as the dollar falls back to more normal levels and as economic growth returns to the industrial world. Several factors suggest that it may be more difficult to return to the days of relative harmony in agricultural trade. One such factor is the much greater dependence upon export markets by the U.S. farm sector. Domestic agriculture has the capacity to export $45-50 billion worth of farm products. It seems unlikely that government programs can for long afford to hold that capacity in check. And yet if the markets are not there, the producer will have to make the painful adjustment. The remarkable growth in exports during the 1970s has left U.S. agriculture more exposed and more dependent upon trade than in previous periods. The stakes in the agricultural trade game are much higher this time around.

Along with the greater dependence of the U.S. farmer

on foreign markets has come increased competition from other suppliers. Market shares, as well as total market size, are under pressure. Much of the growth in exports came from a policy of competitive pricing at home and a relatively cheap dollar abroad. U.S. foodstuffs were a bargain in overseas markets. Now other countries, anxious to move their own products into these markets, find it relatively easy to undercut U.S. prices. The U.S. has refrained, quite properly, from an all-out subsidy war, but the result has been the loss of outlets to others who are less restrained. The U.S. has instead borne much of the adjustment through storage programs and set-asides. These policies, combined with a generous deficiency payment program that shielded farmers from the weakness in foreign markets, have led to formidable budget costs. Again, this willingness to finance agriculture over a period of slack demand has raised the political temperature of the farm trade debate. The need to control government spending has arguably a higher weight in the political balance than the need to indemnify agriculture for past investments. If other exporters have different priorities, then even a recovery in export markets may not be enough to prevent further weakness in farm incomes.

The View from Abroad

If trade relations in the agricultural arena are soured by an inherent conflict in agricultural policy objectives, any improvement in such relations must be dependent upon at least a partial modification of those domestic objectives. Other countries in the industrialized West would obviously like the U.S. to make such adjustments. An efficient, low-cost U.S. farm sector is something of an embarrassment to Japan, the EC and even to Canada and Australia. One "solution" to this problem would clearly be a change in U.S. policy, downplaying the role of exports in generating adequate farm incomes and avoiding confrontations in the trade arena. At the other extreme, the burden of policy adjustment could be borne by other countries. The EC could "see the light" and move towards a system of modest protection by non-trade measures, or Japan could openly declare its own agriculture to be redundant, save some limited part-time enterprises based on the advantages of location near consumption centers. Neither extreme is very likely; the compromise will be worked out, if at all, on a more pragmatic basis. How far other countries are likely to move their own domestic policies in response to trade pressures is the subject of the present section. The emphasis is on the EC and Japan, with competing exporters--Canada, Australia and New Zealand--mentioned briefly at a later stage.

The European Community has emerged as a major force in temperate zone agricultural trade. Imports of agricultural and food products account for about one-quarter of total

world imports of these commodities, though much of this trade is in tropical products. Imports of animal feed, chiefly soybeans and corn from the U.S., have remained high despite increased agricultural production. But the emergence of surpluses of wheat, barley, meat, dairy products, sugar and wine have added to the importance of the EC in trade. The nature of trade relations has changed as the EC markets have become more dominated by surpluses. Imports have been seen less as a natural consequence of low land-to-labor ratios, relative to North America and Australia, and more as constraints on the sale of domestic produce. The need to dispose of surpluses on export markets has led to more aggressive behavior and brought the EC into increasing conflict with other exporters. The Community has yet to redefine its domestic policy to take account of the new market balance; until it does so, conflicts will continue to be common among otherwise friendly nations.

Trade relationships in the agricultural sphere have become most complicated, and most antagonistic, between the U.S. and the EC. Set up following the 1957 Treaty of Rome, the Community represents a wide-ranging attempt to integrate the economies of its member states (now ten in number) by a combination of liberal trade and free competition within its borders and protection of its industries from those overseas by means of common trade measures. This objective was achieved with remarkable success throughout the 1960s, and the attraction of foreign investment into the EC to take advantage of the protected internal market continued the work started by the Marshall aid program of reconstructing Western Europe. The U.S. saw significant geopolitical advantage in such economic strength and supported the process even when its own interests were compromised. The steady reduction of trade barriers in manufactured products, coupled with the expansion of the free-trade area to include other Western European countries, has blunted the effect of a protected industrial market. By contrast, the common agricultural market now stands exposed as an island in the ocean of international trade, a monument to the inward-looking agricultural policy which has been its guardian.

It is understandable that in such circumstances the U.S. should turn its attention to agricultural trade matters and other sectoral problems (such as steel) which also reflect government dominance of the marketplace. But to assess realistically the chances for accommodation in agricultural trade relations, one has to examine the constraints under which the EC labors. The Common Agricultural Policy (CAP) leads a double life. On the one hand, it is an income support system for EC agriculture, subject to the same pressures and limitations as other similar policies; on the other hand, it is a part of the complex pact among member states forged

over 25 years of negotiation on common policies. As a support program, its main distinguishing feature is that it relies on border instruments to a larger extent than many developed countries. The cornerstone of the policy over much of its life has been the variable levy, a device that effectively isolates EC agricultural markets from world price changes. For some minor commodities, direct producer aids are given, and for sugar a system of production quotas has been in existence for some years. But in the main, the levy on imports has been the principal device for protecting farm incomes. The policy has been nothing if not successful. Sheltered from the winds of competition, agriculture has responded impressively to the generous price incentives afforded it by the CAP. The present problems, indeed, reflect this success. For commodity after commodity, the Community has become a net exporter. The weight of market support has shifted from the regulation of imports to the subsidization of exports. This has become at the same time increasingly expensive and increasingly irritating to overseas countries. Viewed as an agricultural policy per se, it should be reformed to take account of the new realities.

It is the role of the CAP as an intergovernmental pact within the EC that makes reform of the policy much more difficult. The CAP is often said to rest upon three "pillars"--the system of common prices and market support systems, the granting of preference for community producers, and the common financing of common programs. Each of these is a logical outcome of the decision to have a common policy. Different support instruments and markedly different prices would vitiate the aim of a common internal market and lead to continuing disputes among member states. Similarly, the notion of freer access for member state produce in internal markets relative to that accorded to outside suppliers is also fundamental in a common market. And if levy revenue were the property of the importing-country government, while exporting countries paid for their own export subsidies, the attractions of importing from third-countries and exporting to partners would soon cause price supports to collapse. The problem is not with the conceptual basis for these "pillars" but with their practical effects when price supports are excessive.

High prices, to importing countries, imply high import costs whether or not imports come from partner countries or from the rest of the world. Those same prices, to exporting countries, mean greater incomes from foreign sales irrespective of their destination. Importing countries no longer face the option of buying at the world price; the usual economic calculus of comparing such prices with the cost of domestic production is irrelevant. Exporting countries also have no interest in world price levels; the higher the common

price the more they get for their sales. As a result of the quite logical structure of the CAP, world prices become largely meaningless to the individual countries of the EC. By extension, any discussion about world trade problems in agricultural products loses its immediacy; the level of the common price becomes the main focus for each individual country. The CAP as a support mechanism isolates EC farmers from world market trends; the intergovernmental arrangements for common policies and common finances isolate EC governments from world market concerns. As a recipe for frustrating trade relations, it is hard to think of a more potent mixture.

Does this mean that the CAP is condemned forever to be hostage to the internal struggle between the importing and the exporting interests within the Community? There are signs that the impermeability to outside events may be coming to an end. For the first time, the budget cost of the CAP has become a real factor in determining the change in annual farm prices. The CAP is financed, along with other Community programs, from the revenue from customs duties and import levies and from the proceeds of a uniform tax of up to 1 percent on "value added" (roughly, GNP) in member states. This last component has acted as a balancing item, being paid by member countries only as required to meet expenditure. This year, such expenditure is expected finally to exhaust the available finance. The issue of control of spending under the CAP (usually known, not too accurately, as CAP reform) was taken up at the recent summit meeting of heads-of-government, along with the topics of increasing available finance for EC programs, correcting the imbalance in the burden of such financing (the UK budget contribution issue), and preparing for enlargement of the EC to include Spain and Portugal. Though agreement on the full package of measures eluded the summit, some important decisions were made on agricultural policy. Whether these decisions represent a turning point in the policy is still moot.

The centerpiece of the "reformed" agricultural policy is the introduction of dairy quotas. Long seen as the most problematic sector for community policy, the dairy industry has been consuming between 30 and 40 percent of the agricultural budget, or around one-quarter of the total EC expenditure. Even at price levels well above those on world markets, the dairy sector provides less than 20 percent of farm receipts. Production is far in excess of the slowly growing consumption, and the surplus has a value, as butter and skimmed milk powder, of only about one-third of the price received by producers. The obvious solution would be to cut the price incentive to producers, a move which would also increase domestic consumption and reduce the cost of export subsidies. Such a mechanism was in fact put into place two years ago, with the establishment of "guarantee thresholds"

which if exceeded would trigger a downward adjustment in the next period's price. But just as the U.S. chose recently to introduce paid diversion for milk, rather than reduce support prices, so the EC ministers opted for quotas by farm (or in some cases, by dairy plant) backed up with punitive taxes for overproduction. Although the program is slated for a five-year trial period, it would be naive to think that it can easily be replaced at a later date. Countries are already seeking ways to increase their quotas, by exempting for instance farms that have recently made publicly-financed investments in dairy production, and producers will undoubtedly lobby for an increase in the price of quota-milk. Experience with the sugar regime, where quotas have been in place, suggests that they are effective in limiting program costs but less successful as a way of reducing surpluses.

Other policy changes in the recent "reform" package have the same air of misguided optimism about them. The decision to switch to a common currency unit based on the Deutsche mark, rather than stick with the present European Currency Unit (ECU) which contains all currencies, is a case in point. It avoids a perennial problem for the German agriculture minister, who has been under pressure to reduce farm prices to reflect the relative strength of the Deutsche mark. Instead, it allows weak-currency countries, in particular France, to raise their own price levels further than would otherwise be the case. The average price level in the Community, and hence the level of protection and the rate of export subsidy, is almost bound to rise. What might arrest this process is the need to limit budget spending. But as a quid pro quo for CAP "reform," member states are about to raise the amount of available finance. To lift the budget ceiling and set in motion a group of policy changes which invite further price increases is hardly a move in the direction of more responsible policy. The CAP has apparently escaped yet again from its own financial predicament.

Japan. If the agricultural policy of the EC has been burdened by its own success, that of Japan is a victim of its own failures. Japan has very limited land area available for agriculture. Some 600 thousand full-time and four million part-time farmers operate on less than six million hectares of usable land. The average farm size, of one to two hectares, can be compared with the U.S. at 158 hectares, the U.K. at 70 hectares and France at 28 hectares. There are products that are suitably grown on one to two hectare farms, but cereal production and cattle grazing can only be supported with heavy state interventions. Rice prices, for instance, are presently on the order of four times world market levels. And the main instrument of Japanese policy designed to arrest the growth of rice farming is to give subsidies for the production of other crops such as barley

and wheat. Japanese agriculture struggles under a structure of small part-time farms neither internationally competitive nor technically productive. Compared with the aggressive efficiency of Japanese industry, such a farm system is at best anachronistic and at worst a severe impediment to further development.

European agriculture has undergone a period of rapid off-farm migration coupled with strong increases in productivity. The umbrella of price support has combined with the lure of off-farm employment to reduce the farm population dramatically over the past thirty years. By contrast, the number of Japanese rural households has dropped more slowly. The dominant farm type is one which offers the family little in the way of income from farming; its purpose seems to be more a form of social security against the loss of urban employment and of a retirement home or speculative investment. As a reaction against the feudal land-holding patterns of the past, and as a hedge against the still vivid memories of large-scale food shortages, one can sympathize with the desire of the Japanese family to hold onto land. But the economic system seems designed to perpetuate this situation, whether it is desired or not. There is no reason why farms should not be managed--through rental arrangements or cooperative enterprises--in units which are larger than those owned by the individuals. This separation of farm management from ownership allows some realization of scale economies to go along with the security and retirement objectives. Japanese policy has recently recognized this possibility by making it easier to rent farm land to others while still retaining the right to repossession at a later date. As in Italy, the legacy of post-war land reform, designed to help the tenant but effectively freezing farm structures and preventing modernization of holdings, is giving way to more flexible tenure arrangements.

To say that Japan smothers small farmers in a blanket of protection is, however, to ignore the very real degree of trade liberalization that has been accomplished in post-war Japan. Imports of agricultural products from the U.S. increased from $260 million in 1960 to $6.5 billion in 1980. Japan is by far the largest single market for U.S. farm products, and the U.S. is the dominant supplier of these products to Japan. It is often pointed out that there is more U.S. farm cropland devoted to growing commodities for consumption in Japan than there are arable acres in Japan itself. In fact, Japanese protection has been remarkably selective. The rice market is reserved entirely for Japanese farmers, even though this staple could be imported far more cheaply from abroad. Strict quotas govern imports of beef, dairy products and certain citrus fruits; cereal imports are also subject to regulation by the Food Agency. Fruits and

vegetables, though no longer subject to quota restrictions, have to pass certain phytosanitary requirements which effectively regulate imports. Feed grain and oilseed imports, however, are allowed into the market with relative freedom, and poultry and pig products are essentially liberalized. Whether the trade pattern and volume have emerged because of, or in spite of, Japanese policy can be argued; the result is a remarkably open market for a wide variety of products of interest to U.S. agriculture.

The relative harmony of U.S.-Japanese agricultural relations is broken by skirmishes over particular commodities. Two among these that have been contentious in recent years are beef and oranges. Both these commodities have been subject to import quotas which have restrained the volume of imports from the U.S. In both bases, the relaxation of import quotas has been opposed vigorously by domestic farmers fearful of losing a part of their market. Beef is raised both on part-time farms, along with the ever-present rice, and on the generally larger dairy farms. The specialized (wagyu) beef is higher in quality and in cost; it competes directly with U.S. premium beef. Quota liberalization threatens the privileged market position of this product. No great issues of food security or the stability of farming are at stake. The part-time beef producer is under pressure from the expansion of the dairy herd at home as much as from foreign suppliers. The Japanese government has a politically awkward choice to make, since it has traditionally drawn much of its electoral support from the rural sector. But the issue is essentially the long-term restructuring of the agricultural base and the granting to consumers of a wider choice of commodities at a reasonable price. The recently agreed increase in quotas for quality beef, by an annual 6,900 tons for the next four years over the present 30,800 tons, indicates that the government is prepared to face the domestic consequences for the sake of improving the climate of trade relationships.

The citrus issue, like the beef quota problem, pits strong U.S. exporting interests against a particular group of Japanese farmers. In this case the question is not so much the expansion of the market for a highly protected product (since Japanese citrus consumption is high by international standards) as overproduction of one type of citrus fruit, mandarin oranges, as a result of a substantial increase in acreage over the past twenty years. There is now a glut of such fruit on the domestic market, and the government has been encouraging the grubbing of orchards. Consumers favor imported oranges when available; the domestic industry is asking for time to improve its quality and develop a processing outlet for seasonal surpluses. As with beef, the recent increase in the quota indicates a willingness of the Japanese

government to find a compromise between conflicting interests. The quota for imports of fresh oranges will rise from the present 82,000 tons by an annual amount of 11,000 tons over the next four years, and the barriers against orange juice and grapefruit juice imports are also to be relaxed.

Competing exporters. U.S. agricultural trade relations with Japan reflect that country's status as a major importer. Only in rice is there any hint of problems of Japanese exports posing a problem for U.S. foreign markets, and the Japanese government has taken steps to prevent direct competition with U.S. suppliers. In the case of Europe, the exporter-importer relationship exists in feed grain, soybeans, and some livestock and fruit and vegetable products. The productivity of EC agriculture has transformed the relationship, for wheat and flour in particular, into one of competing suppliers to third markets. The competitor relationship is dominant in the case of Australia and Canada, though there is also considerable bilateral trade. This relationship is directly related to the state of world markets. If business is booming, competitive exporters find little about which to argue; if demand slackens, they tend to turn their attention to each other's marketing practices and domestic support policies.

Institutional differences in grain marketing have heightened the suspicion with which countries view each other's policies. In particular, the existence of monopoly selling agencies for Australia and Canada have led to periodic concern about their ability to undercut U.S. prices and secure a higher share of the market. In general, the market power of these grain boards has probably been overestimated; they have to sell the domestic crop in competition with other exporters but have little direct control over production. They are essentially "price-takers" in the international market for feed grains, and follow the lead of the U.S. in the wheat market. Increased flexibility in the granting of export credits in the U.S. and the willingness to enter into bilateral arrangements at least with central-plan economies, have prevented the more tightly organized selling agencies in Canada and Australia from capturing markets. Meanwhile, all three traditional grain exporters, as well as Argentina, have been affected by the indiscriminate use of export subsidies by the EC. Though relations among exporters are not always smooth, the underlying identity of interests seems to prevent weak-market frictions from getting out of hand.

As problematic as inter-exporter issues between these three countries have been the trade flows in which one country is an importer. Canadian imports of U.S. feed grains and U.S. imports of Australian meat are examples. The long

border between the U.S. and Canada encourages trade and specialization. Ontario livestock producers can as easily tap the Midwest corn belt as their own western provinces. British Columbia is a part of the market for California fruits and vegetables, participating in the seasonal specialization pattern that includes Mexico and the southwestern states. Policies have generally been accommodating to this trade. The Canadian government now allows freer access of U.S. feed grains into its own market (the relatively low tariff was reduced in the 1979 GATT Round) and imposes no restrictions on soybeans. Moreover it has liberalized a part of its domestic market for feed grains, allowing producers to sell to the open market rather than to the CWB if they prefer. As a consequence, U.S. and Canadian feed grain markets are largely integrated, with the U.S. market tending to set the price. For fruits and vegetables, the integration of the market has even been incorporated into the instruments of market management—such as the extension of the Arizona-California citrus marketing order—to include the market in Western Canada. Provincial marketing boards on the other side of the border, such as for eggs, dairy products and tobacco, tend to limit trade, however, though in many cases the U.S. is treated no worse than other Canadian provinces.

Australian meat imports into the U.S. have been subject to quantitative controls, varied by the state of the U.S. market. Since the effective closing of the European outlet for Australian beef, the North American market has become more important. The U.S. seems content to import manufacturing beef from Australia and to search out markets in Canada, Japan and Europe for higher quality meat. Australian concerns have centered around the destabilizing influence that "counter-cyclical" beef imports into the U.S. have on domestic producers. Just as the beef cycle appears to have become synchronized between Canada and the U.S. in recent years, so the Australian industry seems always to have most to sell when least is required. The obvious solution, to shift the cattle cycle so as to render it out of phase with the major export market, seems to have eluded producers and governments alike. Livestock and meat trade between Canada and the U.S., relatively free of impediments historically, also shows signs of tension when markets are weak. Charges of trans-shipment of Australian beef through Canada, and of overzealous interpretation of health regulations on U.S. exports to Canada are symptoms of such problems.

Trade relations with New Zealand, perhaps the most specialized agricultural exporter in the developed world, have generally been cordial. Imports of sheepmeat have an accepted place on the U.S. market, though again responding to the state of the internal market. The main commodity where U.S. and New Zealand policy are most interlinked is

processed dairy goods. In common with Canada, the EC and Japan, the U.S. controls dairy product imports and stimulates the domestic production of similar commodities. Much of the natural cost advantage of the New Zealand dairy sector is thwarted by such protectionism. The traditional market in the U.K. is shrinking under pressure from other EC dairy exporters and from increased domestic production. However, the U.S. has at present refrained from seeking subsidized outlets for dairy surpluses which might directly compete in the few remaining dairy import markets. In a gesture of some generosity, the U.S. has tacitly been assisting in the support of the world market price for butter and skimmed milk powder by building up large stocks, and more recently by attempting to cut domestic production. Although the main beneficiary has been the budget of the EC, New Zealand has been saved from a total collapse of export earnings in this market. How stable this implicit "tri-opoly" in the dairy products market will prove will depend upon the success of the EC and the U.S. in cutting production. Chances at the moment do not look too bright.

The Future of Trade Relationships

If the analysis of the earlier part of this paper is correct, the inherent conflict of interest among countries in agricultural markets will continue as long as governments are directly involved in managing the markets for domestic producers. Other papers in this series can speak to the chance for change in U.S. policy. Liberalization of import regimes would doubtless help the image of U.S. agricultural policy, as well as the pocketbooks of U.S. consumers. It is difficult to argue effectively that the EC should not protect its grain market against a surge of non-grain feeds if injury to domestic farm interests and the vulnerability of domestic support programs can be cited as reasons for excluding foreign goods from the U.S. market. And the case against deliberate, open and predatory export subsidies in third country markets is more difficult to make if domestic support prices are above world market levels and export credit terms are made generous enough to avoid the need for explicit subsidies. On the other hand, a move away from supply control and from the use of stocks to help stabilize world markets would be a serious blow to other countries in their external agricultural policies. U.S. farm programs in total probably are more satisfactory to agricultural interests in other countries than the alternative of unfettered competition and no-holds-barred free trade.

Rather than concentrate on domestic policy options, it is worth considering the possibilities facing the U.S. for future trade policy. In essence, there are three alternative models that the U.S. could adopt in its trade relations with

otherwise friendly states. These can be characterized as unilateral, bilateral or multilateral approaches to trade policy. Within each, there are various modalities and strategies, and some mixture of approaches may be possible. But the alternatives are presented here in contrast to highlight the choice.

Unilateral policy. Despite the interrelatedness of national concerns in agricultural trade, it is still possible to think of trade policy as being essentially unilateral and reactive. A country can take as given the state of world markets, including the impact of other countries, and fashion its own policies accordingly. The U.S. is dominant enough in agricultural trade to force others to react to its own policy decisions--with or without any international discussion of such adjustment. Two variants of the "unilateral" approach seem to be in the cards at present, one emphasizing confrontation and the other emulation. A few sentences on each will suffice to give the flavor of these options, without any pretence at a comprehensive treatment of the benefits and costs.

Confrontation implies the use of policies which deliberately lead to a situation where other countries must modify their behavior. One example of confrontational policies would be to use targeted export subsidies to displace other countries in particular overseas markets. Such subsidies could be effected by the use of the various export credit programs already in existence. In this way, one could drive the EC out of, say, the wheat flour market in Egypt and Algeria, and the wheat market in China and the Middle East barley market. Targeted subsidies tend to cost less than those of general applicability, and such an approach would allow the U.S. to regain some lost market shares. Another example of confrontation would be to use the mechanisms set up under the GATT to counter the excessive use of export subsidies not just for obvious and blatant cases but as a form of policy harassment. The EC is vulnerable in many markets to charges of violation of the GATT, as is Japan; the decision to press complaints at every turn would indicate a heightened level of confrontation and tension.

On another tack, confrontation could be taken into the area of U.S./EC and U.S./Japan trade flows themselves--rather than that of the struggle for third-country markets. Higher prices for corn and soybeans, if such an outcome could be staged, would serve notice that the importing arrangements of those countries allowed the capture, in import levies or the profits of the Food Agency, of revenue which could go to the U.S. producer. An attempt to use apparent market power in products where the U.S. is the dominant supplier has much

domestic appeal. Similarly appealing is the notion of retaliating on imports from these countries for the harmful effect of their policies. The "chicken war" of the 1960s was a notable case of such retaliation and could be repeated in the 1980s.

The main feature of such confrontation strategies is that they tend to spread ill will to other areas of commerce and international relationships. Predatory subsidies, harassment through the GATT, the use of market power and the act of retaliation would each sour relationships to an extent that is difficult to foresee. The casualties from subsidy wars are farmers, not the exporting countries; retaliation hits domestic consumers; GATT challenges weaken support for that body; and monopolistic selling undermines the notion of liberal trade regimes all round. In short, the baby could disappear with the bathwater.

Emulation has a somewhat less threatening ring. If other countries dump dairy product surpluses, then why should the U.S. not do the same? If wheat is sold on world markets at a fraction of the domestic price, then why should the U.S. not counter with general export subsidies of its own? And if other countries make use of variable levies to counter import competition, may not such an approach be feasible for the U.S. in, say, meat? The selling of grain by state agencies is common to Australia and Canada; why should the U.S. not set up its own selling agency? And the EC wine policy, involving numerous aids to producers, might help to solve some of the problems of the domestic industry.

Unfortunately, emulation of the trade policies of other countries is not an easy or costless option for the U.S. Other countries would be hurt, though it is unlikely that major changes in policy would be brought about by such a strategy. Instead, as with a confrontation strategy, the costs to the protagonists would increase, including substantial budget costs in the U.S., to the advantage not of domestic farmers but of countries such as the USSR that pick up surpluses in the world markets without having to worry about the objections of domestic farmers. In effect, a switch to EC-type policies by the U.S. would remove much of what remains of rationality and cost advantage in world markets, and substitute a subsidy war of potentially enormous proportions.

Bilateral policy. The unilateral approach has domestic support, and seems to fit in with a "tough" foreign policy line in other areas. To those with a professional interest in diplomacy and with a concern about the deterioration of trade relationships, such autarchic policies slide quickly into anarchic ones. More popular at present are bilateral

solutions. If the U.S. has a problem with the EC, or vice versa, why not settle the matter bilaterally, through regular ministerial meetings and negotiations? The success of bilateral talks with Japan is a sign that such an approach can work; the lack of success in U.S.-EC talks makes one wonder about its applicability in all cases.

The bilateral approach rests for its effectiveness on one of two premises, that the subjects under discussion are of interest only to two countries, and that broader agreement, even if desirable, is less likely. The first condition is presumably met fairly often in specific cases where issues such as quality standards are under discussion but less often when discussing price policies in widely traded commodities. As a fall-back when multilateral talks fail, it has some merit, but it can also cause further problems by its success. Australia, for instance, has reportedly taken exception to the notion that the U.S. is the logical source of Japan's increased beef imports. The notion of negotiating bilateral access is itself at odds with the attempt to maintain an open trading system.

What then might such a bilateral approach properly cover? Two different types of agreement need to be distinguished. The U.S. could enter into more or less formal pacts with other <u>exporters</u>, such as with Canada for wheat or Australia for beef, to avoid "costly" competition. This idea has been current in various guises for some years among producer interests. What stops such notions from gaining too much ground are the implications for domestic policy, that a higher degree of U.S. government involvement in trade is necessary, and the doubtfulness of the longevity of such pacts, when all evidence suggests that the result is to stimulate production in other countries. On the other hand, the U.S. could negotiate bilateral agreements with <u>importers</u>, in the sense of bargaining policy modification for either guarantees of supplies (which might appeal to Japan) or of export restraint (as requested in corn gluten by the EC). Such bilaterals could also involve non-agricultural goods; it is somewhat odd that agricultural talks with Japan have not been functionally linked to automotive and electronic trade issues more explicitly. Such bilaterals would have more meaning than the largely informational long-term bilaterals with PRC and the USSR on grain, and with the Abe/Butz concord with Japan. But they remain in the world of "second best" when the problems themselves call for wider action.

<u>Multilateral policy</u>. If the bilateral approach is largely an admission of failure at the multilateral level, the issue facing U.S. trade policy is whether any multilateral approach can succeed in the present era of commercial confrontation and diplomatic mud-slinging among allies. Though

it is not necessarily the case that all trade questions are amenable to multilateral discussion, the broad direction of the trading system can hardly be discussed at any other level. Hence the issue of agricultural trade, rapidly becoming isolated as a major problem for the GATT, cannot be forever swept beneath the rug. Some start has been made on establishing the basis for trade negotiations in agriculture, though with considerable reluctance in the case of the EC. The OECD, with a more limited membership, has also launched a set of studies designed to lead to negotiations. It is possible that the bilateral talks can themselves speed up the multilateral negotiations by allowing issues to be clearly identified. Though it is not yet clear what the scope of any future negotiations will be, the ducks are slowly being brought into line.

The main question for such a negotiation will be the same as has haunted previous attempts at multilateral discussion of agricultural trade. To what extent can national agricultural policies be discussed directly, as opposed to being held sacrosanct? The U.S. is in a position to make a bold move to change the rules on such procedure. It could, for instance, release the well-known waiver granted to it by other countries which recognized that domestic policy needs could dictate trade policies even when those policies were out of line with GATT procedures. This in turn would require a modification to Section 22 of the Agricultural Adjustment Act, which mandates the supremacy of domestic policy. This would imply a willingness to bring national policies into accord with the needs of trade relations. Such a move would have been unthinkable with only a small interest in trade, but with exports providing the balance wheel for domestic producers, the gamble might be worth taking.

The U.S., under such a scenario, would essentially be agreeing, and asking other countries to agree, to lay certain aspects of domestic policies on the negotiating table. No sovereignty would be given up; no domestic policy decisions would be made collectively. But the reality of the influence of domestic policy over trade flows would be recognized. Countries would no longer have to negotiate with a mandate already so circumscribed that no progress is possible. Rather than saying to the negotiators, "Gain some markets for us, but do not compromise our cherished national programs," the mandate would be, "Search for agreements which will lead to a constructive improvement in the international environment in which our agriculture must compete even if it means limiting our freedom of action on domestic policy." The glimmer of hope for such an approach--and it would be misleading to be any more positive about the chances of success--is that both the EC and the U.S. are searching for ways in

which their domestic policies can adapt to the increasingly trade-oriented nature of markets. Progress would be slow, but a corner would have been turned in the search for a better climate in agricultural trade relations among friends.