The Heritage Foundation Backgrounder

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NEEDED: A FARM BILL TO LET U.S. FARMERS TAKE ADVANTAGE OF THE NEW GLOBAL MARKET

INTRODUCTION

Last December, President Bill Clinton signed into law P.L. 103-465, legislation to implement the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), the multilateral trade talks concluded successfully in 1993. Among other provisions, the new pact for the first time subjects trade in farm products to GATT's international trading rules.[1]

This means that U.S. farmers will face substantially lower trade barriers when trying to export their products. Under the agreement, the signatories agreed that all existing non-tariff barriers (including import quotas) must be converted to tariffs, and every agricultural product must be allowed at least some minimum level of access to their domestic markets under low or minimal tariff rates. Countries that export farm products will be required to reduce the volume of subsidized exports by 21 percent and the amount of the subsidy by 36 percent over six years. The agreement also calls for reduction of all domestic agricultural subsidies (such as U.S. farm subsidies) tied to production of commodities and significant reduction of all existing direct agricultural export subsidies.

Along with the new regional market opened up by the North American Free Trade Agreement (NAFTA) and the prospect of expanding free trade arrangements involving the United States,[2] ratification of GATT will open up a potential marketplace of six bil-

1 For a full discussion of the provisions of the Agriculture Agreement, see Joe Cobb, "A Guide to the New GATT Agreement," Heritage Foundation *Backgrounder* No. 985, May 24, 1994.

2 See Michael G. Wilson, "Building on the NAFTA: Forging a Free Trade Agreement with Chile," Heritage Foundation *Backgrounder* No. 991, June 27, 1994.

lion customers for U.S. farmers—compared with the U.S. domestic market of only 250 million people.

An econometric analysis conducted by The Heritage Foundation indicates that, with reasonable assumptions regarding an increase in U.S. production, the income net of farmers would increase by over $2 billion in 1996. Moreover, even if all agriculture subsidies were phased out, net farm income would increase by nearly $4 billion annually within 10 years.

The ability of American farmers to seize the opportunity provided by this vast new market, however, will depend upon the willingness of lawmakers to enact major changes in U.S. farm policy. America possesses the most productive land resources and advanced agricultural infrastructure in the world, yet U.S. farmers have been unable to capitalize on these advantages because of the highly restrictive nature of today's farm programs. Thus, even though world consumption of food and agricultural products has increased substantially since 1981, U.S. agricultural exports have decreased overall, and exports of unprocessed agricultural commodities have fallen (see chart on page 4).

One major obstacle that must be removed if U.S. farmers are to take advantage of GATT is supply-control policies, specifically the annual acreage reduction programs (ARPs) and the Conservation Reserve Program (CRP). These programs have removed on average over 15 percent of U.S. acreage from production annually and thus limited the opportunity of farmers to export. To appreciate what this means, it is as though government policies had shut down 15 percent of the U.S. computer industry while the international market for computers is booming. Meanwhile, agricultural producers in the rest of the world have increased their production to fill the void created by reduced U.S. production. These foreign producers have sold their products at a lower price, thereby making the United States the "residual supplier," or the last seller to be chosen in most markets.

Another obstacle that stands in the way of farmers taking advantage of GATT is the Export Enhancement Program (EEP), which subsidizes the dumping of U.S. agricultural products on the world market. Although EEP was intended to make U.S. farm products more competitive, the program is counterproductive. In fact, U.S. export subsidies depress world prices while domestic prices remain high, creating a price differential that has made the United States an importer of some agricultural products.[3]

The United States has an opportunity to reverse these policies and restore the competitive position of American agriculture when Congress considers the 1995 farm bill. Because farm policy is reauthorized only every four or five years in the farm bill, this year's bill will be the first opportunity to revise these policies to take advantage of GATT.

3 This was demonstrated last year when U.S. supply control programs contributed to a short supply of durum wheat—a specialty crop used in making pasta products—leading to increased imports of Canadian wheat in order to supply U.S. pasta makers.

For U.S. farmers to benefit from the world market opened up by GATT, Congress needs to incorporate the following changes in farm legislation:[4]

- ✔ **Eliminate all acreage reduction or set-aside programs.**
- ✔ **Modify the Conservation Reserve Program to include only highly erodible acres.**
- ✔ **Eliminate the Export Enhancement Program.**

The U.S. policy of unilaterally idling massive land resources already has led to a significant loss in America's share of the expanding world market. This has shrunk farmers' ability to earn income from the marketplace, held back the development of agribusiness infrastructure, and caused economic problems for many rural areas. By eliminating acreage reduction programs and modifying the Conservation Reserve Program, Congress could make sure that U.S. agriculture once again becomes the leading force in the world export market by enabling U.S. farmers to take advantage of the promised benefits of GATT's trade liberalization and reform. And by eliminating the Export Enhancement Program, the U.S. will no longer be employing a trade-distorting practice that actually undermines the potential of certain export markets.

The enormous export potential of American agriculture has been held back for years by federal policies that largely ignore the huge world market. GATT makes that world market potentially even larger and attractive to U.S. farmers. If the 1995 farm bill revamps policies so that farmers can make full use of agriculture's productive capacity to compete in the world's market, U.S. farm income will increase and the rural economy will receive an enormous boost, creating jobs, producing greater prosperity, and reinvigorating distressed communities. But if the farm programs are not revised, rural America will stagnate while other countries exploit the new markets opened up by GATT.

A HUGE OPPORTUNITY FOR U.S. AGRICULTURE

The 1994 legislation implementing the GATT agreement modified U.S. trade laws affecting agricultural imports in several ways. The Meat Import Act was repealed, as were restrictions in other trade laws on imports of cotton, cheese, and chocolate crumb to treat these products consistently under the new tariff-rate quotas. Section 22 of the Agricultural Adjustment Act, which gave the President authority to impose quota limits, also was amended so that it now applies only to products from countries that are not members of the World Trade Organization. The U.S. Harmonized Tariff Schedule now applies tariff-rate quotas to dairy products, sugar, sugar-containing products, peanuts, cotton, and beef, replacing the quota restrictions and other non-tariff barriers that formerly regulated those imports.

Unfortunately, the Export Enhancement Program (EEP) was not eliminated in the GATT implementing legislation, although the United States can comply with the restrictions agreed to by observing annual ceilings on export subsidies, which are based on

4 Additional changes needed in U.S. agricultural policy will be addressed in a forthcoming monograph, *Freeing America's Farmers: The Heritage Plan for Rural Prosperity.*

both budget outlays and quantity limits. The EEP, as well as the Dairy Export Incentive Program, was extended through the year 2001. Significantly, the requirement that it be used only to discourage unfair trade practices was repealed. Several mandatory export subsidies were repealed, most significantly the requirement to export a minimum quantity of dairy products to avoid violating the GATT limits on subsidized exports, but the legislation did not end the subsidized export programs. Additional funding was authorized in the legislation that would expand subsidies under the Market Promotion Program, low-interest export credit programs, and programs to develop alternative uses for agricultural products.

While Global Food Consumption is on the Rise, U.S. Food Exports Drop

Billions of Metric Tons	World Food Consumption	U.S. Food Exports
1982	3.258	.187
1983	3.116	.179
1984	3.437	.185
1985	3.519	.153
1986	3.547	.122
1987	3.437	.161
1988	3.362	.180
1989	3.655	.197
1990	3.815	.176
1991	3.669	.164

Sources: *World Economic and Social Survey, 1994,* United Nations, Department of Economic and Social Information and Policy Analysis; *Foreign Agricultural Trade of the United States, Calendar Year 1993 Supplemental,* USDA, Economic Research Service.

The Uruguay Round implementing legislation was narrowly drawn to comply with the commitments made in the GATT Agricultural Agreement to eliminate quotas and to restrict and eventually eliminate agricultural subsidies, but Congress went no farther. The most important step now needed to pursue the opportunities to American farmers from the agreements by other governments is for Congress to use the 1995 farm bill as to vehicle to move toward a free market in agriculture, in which U.S. farmers are given the flexibility to increase production to serve to new world market.

The GATT legislation could mark the beginning of a new era for U.S. agriculture based on greater trade. But only if Congress carries through this year with legislation to unshackle U.S. farmers from the restrictions of central planning. Before the diplomatic breakthrough which made the GATT agricultural agreement possible, trade protectionism in agriculture was practiced throughout the world, especially by such developed countries as the United States and the nations of the European Union. This protectionism has not helped domestic producers, even in developed countries. Explicit import restrictions, including quotas and tariffs, and non-tariff trade barriers, such as unwarranted food safety and quality regulations, merely have hindered the ability of developing countries to penetrate the developed countries' markets. At the same time, the United States and the European Union have been waging a mutually destructive and trade-distorting bidding war, using export subsidies to finance underpriced sales into the developing countries.

The costs of such distortions to agricultural production and trade have been rising steadily while U.S. market share has declined, as demonstrated in the chart on the preceding page. The GATT Uruguay Round agreement is significant because it reverses this trend and reopens competition for markets based on productivity, not protectionist policies.

The GATT opens up huge new marketing opportunities for U.S. livestock products throughout the world, including Japan and Europe (where import barriers have been particularly restrictive). More significantly, GATT will raise the incomes and standards of living in the developing world because global economic expansion will stimulate growth throughout the world. The GATT agreement is expected to expand the world economy by $6 trillion by the turn of the century. This will lead in turn to more demand for higher-protein sources of food. This trend is likely to be most pronounced in the fastest-growing countries of Asia, Latin America, and Africa, where half the population is under 15 years of age and the nutritional requirements are greater than in older populations. By the end of this century, 60 percent of the world's population will be living in Asia, where incomes are rising dramatically. And before the year 2050, it is expected that world population will double and that, due to rising standards of living, world food needs will triple.[5]

For U.S. farmers, this translates into an extraordinary opportunity to increase the export of many agricultural commodities, especially corn, soybeans, wheat, cotton, rice, and livestock products. There are also indirect opportunities due to a larger world market. For instance, the new access into the fast-growing Asian market for beef, pork, and poultry will mean increased domestic consumption of grains by U.S. livestock. Thus, the U.S. grain sector will benefit not only from direct sales of grain, but also from greater sales of grain-fed livestock.

Since U.S. agricultural productivity is rising faster than domestic food demand, agriculture's well-being depends heavily on international trade. If U.S. farmers manage to regain the competitive edge internationally, the share of overall U.S. production going to export will increase significantly; but if this historic opportunity is lost because domestic farm policies hold back potential exports, farming communities will suffer greatly.

Existing U.S. agricultural policies already have hastened the loss of much of the agricultural market in Western Europe. Rather than concentrate their efforts on the daunting task of trying to regain limited markets already lost, however, U.S. farmers stand to gain much more from looking to the growing markets of the future. For instance, farmers need to develop the Asian and Latin American markets and be poised to move into Africa as that market awakens. U.S. agriculture is now at a crossroads where it must use its advantageous position to capture a greater share of these expanding markets stimulated by the rising food needs of a growing population.

5 Dennis T. Avery, "Saving the Planet with High-Yield Farming," paper presented at The Heritage Foundation's Agricultural Policy Roundtable, May 23, 1994.

Domestic Benefits of Growth-Oriented Production and Export Policies

American farmers have much to gain if policies are amended in the 1995 Farm Bill to take full advantage of GATT. For this to happen, however, U.S. policies will have to be changed to raise output rather than curb it and to make prices more competitive. U.S. farm programs today use non-recourse loans, target prices, and deficiency payments to stabilize the income of farmers producing certain commodities. "Non-recourse" means a farmer can borrow money from the government on his harvested crop and then either repay the loan and sell the crop or default on the loan and forfeit the crop to the government. The farmer's credit rating is not affected by his default, and the loan in reality is a minimum guaranteed income from his crop. If a target price is established for a particular commodity, the government pays the farmer a "deficiency payment" (the difference between the target price and the average market price) if the market price falls below that target. Again, this means the farmer has a minimum guaranteed income.

The loan rates also establish a floor under the commodity price and signal to the rest of the world what a foreign producer must charge for his product to beat the American price. Because the U. S. product is usually the higher-priced product in the international export market, buyers often turn to the U.S. market only after first exhausting the supplies offered by other exporters.

Increasing Farm Incomes. Periods of export growth historically have been periods of large income gain for U.S. farmers. In the early 1970s, for example, U.S. grain exports doubled in just four years. According to J.B. Penn, then Deputy Administrator for Economics at the U.S. Department of Agriculture, "net farm income reached the highest level since World War II and parts of the agricultural sector enjoyed nearly unparalleled prosperity."[6]

In the 1980s, on the other hand, the United States priced itself out of international markets by setting too high a floor under commodity prices in the 1981 farm bill. That legislation provided automatic increases in loan rates to reflect the double-digit inflation the country was experiencing at the time. These rigid minimum loan rates effectively established a minimum export price.[7] Foreign competitors undersold these artificially high prices, and U.S. exports fell.

Domestic commodity prices fell even lower because the resulting stockpile of surplus commodities continued to depress the markets. Recognizing that the automatically escalating loan rates in the 1981 farm bill priced American agricultural producers out of the export market, Congress provided flexibility to decrease loan rates in the 1985 farm bill.

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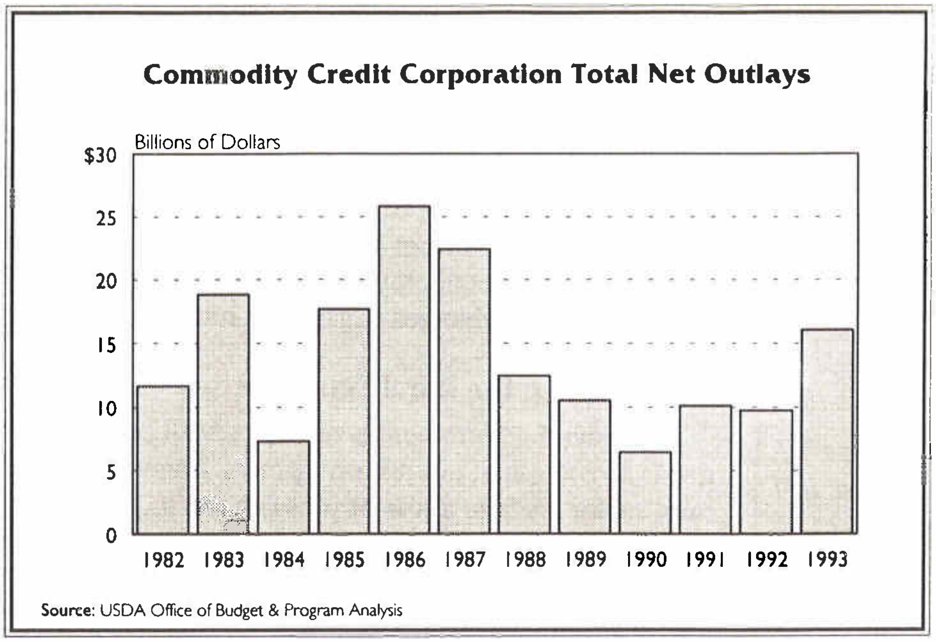
6 D. Gale Johnson, ed., "Food and Agricultural Policy for the 1980's," American Enterprise Institute for Public Policy Research, 1981.

7 Farm legislation sets loan rates for major commodities which establish a floor under the commodity price by allowing the producer to choose to sell his crop and repay the loan or forfeit his crop to the government and keep the money. The 1981 farm bill established these loan rates with automatic escalators, which ultimately exceeded the inflation rate. Rather than selling their crop which conceivably could then have found their way to an export outlet, most producers forfeited their crops to the government and kept the government loan, which was higher than the prevailing world market prices.

Unfortunately, new mistakes were made in the 1985 farm bill. Target prices were kept relatively high, which meant that U.S. farmers became dependent on the federal government for an even greater share of income. Rather than dealing with this budget concern directly, the 1985 farm bill called for a greater reliance on the use of acreage reduction programs to control costs and created the Conservation Reserve Program (CRP), also intended to reduce production available for program eligibility, despite the fact that attempting to bolster domestic farm prices by restricting supply severely limits the export potential of U.S. farmers. Thus, after gaining a growing share of world grain usage in the 1970s, U.S. farmers saw that share fall significantly after the return to supply management policies in the early 1980s.



Source: USDA Office of Budget & Program Analysis

As in any other sector of the economy, a farm policy designed to raise farm incomes should promote growth in world consumption and try to capture a larger share of that consumption for U.S. exporters. Fuller and more efficient use of production resources is the key to this since it lowers unit costs and increases export revenues. In short, greater and more efficient production increases total volume and widens the margin of profit.

A 1994 study commissioned by the National Grain and Feed Foundation indicates that returning 38 million idled acres to production could increase gross farm revenue by $8 billion and net farm income by $4 billion.[8] Taxpayers also would benefit from such increased production because farmers would receive a greater share of their income from the marketplace rather than from the federal government—which for the last 10 years has spent an average of some $14 billion annually on commodity programs (see the above chart).

8 Abel, Daft and [illegible]ley, an economic analysis consulting firm, located in Alexandria, Virginia, conducted a study on behalf of the *U.S. Agr[illegible]ure 20/20 Project* of The National Grain and Feed Foundation. The study "Large-Scale Land Idling Has Retarded Growth of U.S. Agriculture," was released in May 1994.

Heritage Analysis

An econometric analysis undertaken by The Heritage Foundation, to be published in a forthcoming monograph, shows that ending growing restrictions while phasing out subsidies would mean, or net, a huge boost to the income of farmers. The team of analysts, led by Heritage Senior Fellow David Winston, concludes that if 80 percent of idled land were returned to production to meet reasonable increases in future exports made possible by GATT, the impact on farmers would be considerable. Indeed, the analysis shows farmers would enjoy nearly $4 billion in net additional income annually within ten years, even if all subsidies were eliminated. And this estimate does not include the additional boost to the rural economy that would accompany an increase in production, such as extra income for businesses engaged in retailing, farm supplies, and transportation.

Reinvigorating the Rural Economy

The federal government's supply control policies have a widespread impact on the entire U.S. economy, not just on farmers. Stagnant economic activity in the U.S. agricultural sector leads to a loss of jobs not just in farming, but also in the supply, processing, and marketing industries. In addition, agribusinesses reduce their investments of capital needed to replace obsolete equipment and fully utilize technological advancements. This hits major businesses producing such items as heavy farm equipment. Moreover, without capital investment, the United States cannot be a dominant force in processing and selling agricultural products internationally.

Changes in U.S. agricultural policy that stimulate greater output, on the other hand, would give agribusiness the incentive to invest in greater economic efficiency. Such a growth-oriented policy would restore the United States as the world's premier farm producer and exporter. It also would revive the vast and valuable agricultural infrastructure, much of which—though still surpassing that of other countries—has been allowed to deteriorate during the past decade. A free market revolution thus would bring economic growth to rural communities, generating jobs in businesses that provide inputs to farmers and that process and market their crops. This expanded economic activity could generate hundreds of thousands of jobs, providing a much-needed boost to the rural economy.

Increasing agricultural production also would have an impact on the rest of the American economy. A multiplier effect would spread the benefits of increased production from producers to processors and distributors and would include the seed, fertilizer, chemical, transportation, equipment manufacturing, and construction industries. Thus, the study commissioned by the National Grain and Feed Foundation concludes that returning 38 million acres to production would not merely boost farm income by $4 billion, but could "increase national income by $28.9 billion annually and generate over 225,000 more full-time jobs."[9]

Future studies by The Heritage Foundation will examine the secondary economic impacts of an increase in farm production.

9 *Ibid.*

A Pro-Growth Farm Bill in 1995

Ten years ago, the one significant reform in the 1985 farm bill was based on a recognition that the United States, if it was to be a successful agriculture exporter, had to allow farm prices to be competitive. The 1995 farm bill could build on this by enabling farmers to capture the benefits of agricultural trade reform.

In order to capitalize on the future expansion of world trade, the 1995 farm bill must promote and reward growth. The United States produces more agricultural products than it can consume domestically, and the gap between its production potential and its domestic demand base is widening. Agricultural productivity will continue to advance because of biotechnological breakthroughs and the use of such new technologies as "site specific production."[10]

The first goal of the 1995 farm bill thus must be to enhance U.S. agriculture's position as a competitive exporter. In an increasingly competitive market, it is the low-cost producer that will capture new markets and the resultant income. But supply controls and export subsidies inhibit U.S. agriculture's ability to exploit its competitive position. Specifically, in order to achieve a pro-growth agricultural policy and realize the benefits that will flow from such a policy, the following actions must be taken in the 1995 farm bill:

✔ **Eliminate all acreage reduction (ARP) or set-aside programs.**

U.S. agricultural policy uses subsidy programs that rely generally on supply control mechanisms instead of the market to maintain farm income. For most of this decade, the United States has been the only major farm producer to follow a policy of deliberately idling productive land. More recently, the U.S. has persuaded the European Union to begin similar supply control policies. This policy does more than physically limit the amount of product available for export; it also undermines the competitiveness of U.S. farm products overseas because fixed production costs are spread across fewer producing acres. This raises the farmer's cost of production per bushel and leaves the established network of agricultural supply, servicing, and processing industries to operate at a reduced capacity, which raises handling costs and discourages maintenance and reinvestment. Moreover, land idling tends to reduce demand for—and lower the prices of—such things as seeds and fertilizers. When these are exported because of limits on domestic production, the result is lower production costs for America's competitors, who wisely do not limit production.

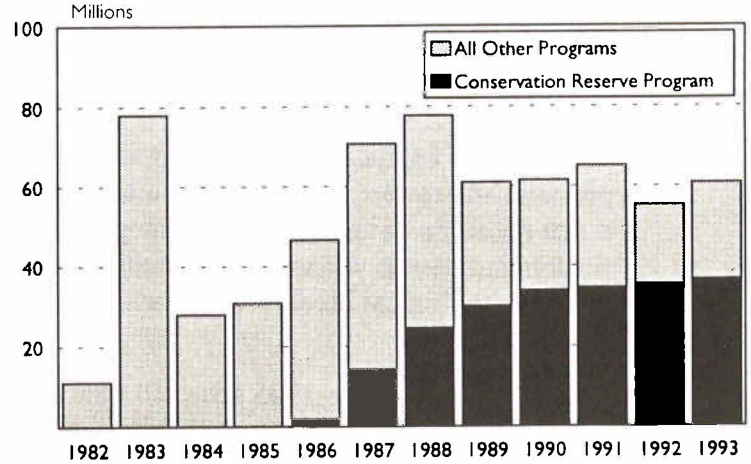
✔ **Modify the Conservation Reserve Program (CRP).**

The CRP, authorized by the 1985 farm bill, was intended to target erodible croplands for removal from production and to encourage conservation. It now includes over 36 million acres on which landowners receive rental payments under ten-year contracts in return for removing the land from production. Much of this acreage actually is highly productive land that, through utilization of readily available conservation practices, is not vulnerable to unacceptable erosion. The CRP contracts will begin to expire

10 When site-specific production becomes available for commercial use, producers will be able to use this satellite technology to maximize production by applying the optimum amount of seed, fertilizer, and nutrients per acre of cultivation.

in 1995, and about two-thirds will expire by 1997. A modified CRP should include only highly erodible acres. Based upon USDA's land capability classification system, about 22 million of the acres enrolled in the CRP are in the top land capability classes with relatively low erodibility. Only 4 million are highly erodible, while the remaining 10 million are of debatable erodibility.

Paying Farmers Not to Grow: Acres Idled by the Department of Agriculture



Note: Acreage Reduction Programs and Paid Land Diversions are included in the "All Other Programs" category. 1983 totals also include payments in kind.
Source: USDA, Economic Research Services

In the last twelve years, acreage reduction programs and the Conservation Reserve Program have removed a total of almost 650 million acres from production. This would cover an area about four times the size of Texas and is some 45 percent greater than the total area of U.S. cropland annually under production, which is approximately 450 million acres (see the chart above).

✔ Eliminate the Export Enhancement Program (EEP).

The EEP pays exporters to dump agricultural products on the world market at discounted prices by providing the exporter a dollar subsidy price for specified quantities of commodities to be exported. Since its inception, the EEP has been used primarily on grains. Previously, the EEP was provided in the form of bonus commodities from CCC stocks. Then, at least, the program added to exportable supplies. Now, even that marginal benefit has disappeared.

Such a program cannot be justified in a post-Uruguay Round world. For one thing, the GATT agreement requires governments to cut back such subsidies. For another, because export subsidies tend to encourage sales of certain commodities by making the purchase of those commodities relatively attractive, regardless of actual demand, they distort markets to the disadvantage of the exporter with the greatest growth potential, which is the United States. Because the EEP allows the United States to continue temporarily to export products based on an artificial stimulus rather than on real demand, it makes the U.S. agricultural system sluggish and unresponsive and wastes resources that could be used better elsewhere.

Continued use of export subsidies will serve only to depress world grain and oilseed prices while distorting buyer-seller relationships between countries. The elimination of export subsidies on grain in particular would improve the global competitiveness not only of grain, but also of oilseeds and livestock produced in the United States.

If these changes in U.S. farm policy are made, U.S. producers will be the best positioned to serve growing world demand. By using the natural advantages that enable it to be the low-cost producer, the United States once again can become a successful exporter of agricultural products.

Obstacles to Reform

These reforms will not happen automatically, however. Certain sectors of U.S. agriculture, such as the National Association of Wheat Growers, National Cotton Council, and National Farmers Union, do not seem to recognize the economic and job-creating opportunities created by the new global marketplace. They believe that GATT will make U.S. farmers more vulnerable to competition from imports. In fact, in hearings held last summer, a number of commodity and farm groups claimed that GATT reforms will make it even more important to keep present farm programs with little or no change in order to protect U.S. agriculture from competition.[11]

Such reluctance to change is natural, since very few farmers have ever known anything other than a system of subsidies and supply controls. But if this siege mentality prevails, it will condemn U.S. agriculture to stagnation while other countries enjoy the fruits of new markets. Fortunately, in a 1994 survey of readers conducted by *Top Producer* magazine, when asked their opinion of a proposal to reform farm programs that would eliminate deficiency payments and set-asides, 26 percent responded favorably. Although 31 percent were opposed, 34 percent were interested but said they needed more information.[12] Some farmers evidently recognize that dependence on government subsidies also subjects them to a lackluster future.

CONCLUSION

Entrepreneurial farmers and agricultural groups should join forces with those agribusiness concerns that led the fight for NAFTA and GATT. Much of agribusiness understands the economic benefits of agricultural trade liberalization and reform. Through past experience with short supply situations, they have learned that supply controls and export subsidies undermine their ability to do business, both here and abroad, and to provide jobs and prosperity in rural America.

A strong voice for a future based on opportunity, not protectionism, is needed now more than ever. U.S. agriculture faces an historic opportunity, as a result of NAFTA and GATT reforms, to reestablish its preeminence in the world export market. If Congress takes the actions necessary to establish America's position as the world leader in meeting the growing demands of this new market, the result will be decades of prosperity ahead for farmers and greater economic growth and stability in rural America.

The 1995 farm bill provides the opportunity to make the necessary changes in agricultural policy. Four or five more years likely will pass before farm legislation is considered

11 The House Agriculture Subcommittee on General Farm Commodities held hearings in June and July of 1994 to review the general outlook for the farm economy and commodity programs.

12 *Top Producer*, opinion survey, conducted in February and March 1994.

again. By then, farmers in the rest of the world already will have taken advantage of the opportunity to meet the demands of the global marketplace. Thus, if this opportunity is missed, rural America will face a future of continued economic stagnation.

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