Agriculture

AN EIGHTH DISTRICT PERSPECTIVE

FALL 1988

Euro-Bashing: The United States Subsidizes Wheat Exports

U.S. wheat exports fell sharply in the early 1980s. Although numerous factors account for the decline, it has been popular to blame the European Economic Community (EC) and its use of agricultural export subsidies. As a result, the United States has retaliated with its own export subsidy—the Export Enhancement Program (EEP). Since it began in 1985, three-quarters of EEP subsidies have been for wheat exports.

The stated goal of the EEP is to meet competition from other subsidizing countries, particularly the EC, as a means of expanding U.S. farm exports. By boosting U.S. agricultural exports, the EEP also pressures the EC by making it more costly to subsidize its exports. In this way, the EEP is designed to force the EC to negotiate a reduction in its use of subsidies.

At first glance, the EEP appears successful because U.S. wheat exports have increased since 1985. It soon becomes apparent, however, that the cost of the additional exports generated by the program has been extremely high. Additionally, side effects of the program may be detrimental to U.S. agricultural trade interests.

Background

The chart on page 2 shows that U.S. wheat exports grew strongly in the mid-1970s before peaking at almost 1.8 billion bushels in 1981. From 1981 until 1985, however, wheat exports fell by almost half. During the same period, EC wheat exports grew from 0.8 billion bushels to 1 billion bushels. Not only had the volume of wheat exports fallen since 1981, the U.S. share of the world's wheat trade also had been falling since the mid-1970s. In 1975, the United States accounted for 43.1 percent of net world trade in wheat. This fell to 25.5 percent in 1985. During the same period, the EC's share of net wheat trade grew from 3.5 percent to 13.8 percent.

The growth of EC agricultural production and exports can be attributed to the EC's Common Agricultural Policy (CAP). The CAP was designed 25 years ago when the EC was not able to produce enough to feed itself and was a major food importer. The CAP stimulated agricultural production by offering high price guarantees to farmers. A tariff known as a variable levy was erected to protect EC farmers from imports of commodities at the lower world prices. The variable levy forces importers to pay a fee equal to the difference between the world price and an established EC support price. Revenues from the levies, in turn, were used to fund part of the CAP. The CAP also established a system of export subsidies known as export restitutions. This subsidy pays EC exporters the difference between the EC market price and the world price. Without this subsidy, EC commodities would not be competitively priced in the world market.

Through much of the 1960s and 1970s, EC export subsidies were not particularly controversial because the EC remained an importer of most major commodities. Over time, however, the stimulus of the high price guarantees and the expansion of the EC to include more countries has resulted in surplus production which is disposed of through subsidized exports. In 1982, the EC spent $4.7 billion to subsidize exports. This grew to $10.2 billion in 1987 and is expected to reach $12.9 billion in 1988. The increasing size and scope of EC exports has not affected only the United States but also has made a dent in export sales by other countries.

Program Evaluation

The primary goal of the EEP is to increase U.S. agricultural exports. The chart shows that wheat exports have increased sharply since 1985, the first year of the EEP. Wheat exports increased by 60 percent from 1986 to 1987. Before declaring the EEP an unqualified success, however, more detailed analysis is necessary.

A study by Kenneth Bailey of the USDA's Economic Research Service analyzed five factors that influenced U.S. wheat exports over the past three years. He found that the EEP was responsible for only one-third of the increase from 1985 to 1987 attributable to the five factors.[1] These findings allow one to

[1]Bailey, Kenneth, "Wheat Explains Wheat Export Rise?," **Agricultural Outlook** (July 1988), p. 22-25

approximate the cost of stimulating wheat exports with the EEP. According to Bailey's findings, the EEP was responsible for roughly a 285 million bushel increase in wheat exports during the two crop years of 1986/87 and 1987/88. During this same period, the market value of bonuses given as subsidies to exporters for the wheat sales was more than $1.1 billion.

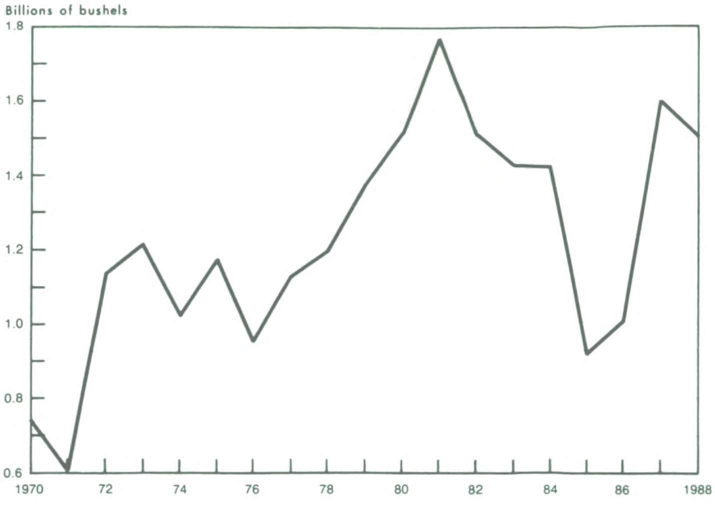
These estimates translate into a government, and therefore taxpayer, cost of approximately $3.85 for every bushel of increased exports. This estimate, however, represents only the lower bound for the cost of the increased exports as Bailey's results only considered five factors behind increased exports. The inclusion of other export-increasing factors would result in an even smaller impact for the EEP. The average U.S. price for wheat during the two crop years of 1986/87 and 1987/88 was only $2.53. In terms of its primary goal, the EEP indeed increased exports, but it did so at an extremely high cost.

Some advocates of the program point out that a secondary goal of the EEP is to pressure the EC to eliminate production-base and trade-distorting farm subsidies as the United States has proposed in the current round of the General Agreement on Tariffs and Trade (GATT). If the EEP succeeded in liberalizing trade, the United States then could reap large gains from future increases in agricultural exports that might offset the cost of the EEP. Instead of capitulating to U.S. pressure, however, the EC responded by increasing its own export subsidies to compete with the EEP. Another indication of the EC's response to U.S. pressure is its GATT proposal on agricultural reform. The proposal stated that the EC's two-price structure of high internal prices and low export prices was not negotiable. At least in the short run, the EC is not amicably surrendering.

The long run prospects for the EEP's success in liberalizing farm trade also are unclear. The primary goal of expanding U.S. farm exports with export subsidies appears to contradict U.S. calls for the elimination of trade subsidies. This inconsistency and the fact that the EEP has harmed nations other than those of the EC may cause the United States to lose the support of world opinion.

Furthermore, EEP strategies may backfire by strengthening the EC's resolve to resist overt U.S. pressure. The EC correctly contends that the United States has long engaged in subsidizing agricultural exports through the price support mechanism of target prices. Target prices serve as a production subsidy by guaranteeing an above-market price to farmers. Because half of the U.S. wheat production is exported, the production subsidy is clearly an export subsidy as well. This, in connection with the EC's perception of the recently signed U.S. trade bill as protectionist and their expectations that the 1990 U.S. Farm Bill will take an even more contentious approach to trade, may cause the EC to dig in their heels about making trade concessions.

United States Wheat Exports



The next opportunity to see the effects of the EEP on the EC's negotiating stance will be at the mid-term review of the GATT scheduled for December 1988 in Montreal. It may show that the confrontational approach of the EEP has increased the willingness of the EC to negotiate, or it may confirm that the EC has adopted an even harder line in the face of U.S. demands.

— Kenneth C. Carraro

This is the final issue of **Agriculture - An Eighth District Perspective.** The Bank's three quarterly regional publications will be merged into one regional publication, **Pieces of Eight - An Economic Perspective on the Eighth District.** Our goal is to increase the usefulness of the Bank's analyses of economic activity in the Eighth District. The new format will allow greater flexibility in covering topics and providing data. **Pieces of Eight** will debut February 1989 and will be published quarterly. Current subscribers of our regional publications will automatically receive the new publication.

Agriculture—An Eighth District Perspective is a quarterly summary of agricultural conditions in the area served by the Federal Reserve Bank of St. Louis. Single subscriptions are available free of charge by writing: Research and Public Information Department, Federal Reserve Bank of St. Louis, P.O. Box 442, St. Louis, Missouri 63166. Views expressed are not necessarily official positions of the Federal Reserve System.

EIGHTH DISTRICT AGRICULTURAL DATA

Prices and Costs[1]	June 1988	July 1988	Aug. 1988	Average for 1987	Percent Change Year-To-Date 1988[2]	Percent Change Same Month Year Ago
CONSUMER PRICE INDEX (% change)						
Nonfood	0.3%	0.3%	0.3%	0.4%	2.9%	3.9%
Food	0.6	1.0	0.6	0.3	3.7	5.0
PRODUCTION COSTS FOR FARMERS (% change)						
Agricultural machinery and equipment	−0.3	0.3	0.3	0.0	1.7	1.8
Fertilizer Materials	−1.6	0.8	−0.1	0.8	9.1	7.7
Agricultural chemicals and chemical products	−0.7	0.3	−0.3	0.5	5.1	6.2
Gasoline	−0.7	2.9	2.1	1.7	8.4	−3.1
PRICES RECEIVED BY FARMERS (% change)						
All products	2.2	2.9	2.1	0.5	13.4	13.4
Livestock	−2.7	0.0	3.4	0.0	7.8	1.3
Crops	8.6	4.7	2.3	1.2	21.4	33.3
FEEDER CATTLE						
Wholesale price - Kansas City ($/cwt.)	$77.38	$79.08	$84.65	$75.36	7.3	6.6
FEEDER PIGS						
Wholesale price - So. Missouri ($/head)	$31.40	$27.57	$27.39	$46.69	−13.7	−43.0
BROILERS						
Wholesale price - 12-city (¢/lb.)	61.50¢	66.50¢	68.70¢	47.42¢	72.6	30.4
TURKEYS						
Wholesale price - Eastern U.S., 8-16 lb. young hens (¢/lb.)	57.10¢	70.80¢	70.50¢	57.81¢	6.0	25.9
CORN						
Wholesale price - No. 2, yellow - St. Louis ($/bu.)	$ 2.77	$ 2.96	$ 2.81	$ 1.76	42.6	70.3
SOYBEANS						
Wholesale price - No. 1, yellow - Central Illinois ($/bu.)	$ 9.13	$ 8.59	$ 8.52	$ 5.33	43.4	61.4
WHEAT						
Wholesale price - No. 1, hard winter - Kansas City ($/bu.)	$ 3.79	$ 3.77	$ 3.78	$ 2.89	2.2	42.6
LONG-GRAIN RICE						
Wholesale price - Arkansas ($/cwt.)	$21.15	$19.00	N.A.	$13.89	−5.9	61.7
COTTON						
Average price received by U.S. farmers (¢/lb.)	61.20¢	58.60¢	N.A.	60.87¢	−8.7	−18.3

U.S. Exports	June 1988	July 1988	Aug. 1988	Average for 1987	Percent Change Year-To-Date 1988[2]	Percent Change Same Period Year Ago
Corn (mil. bu.)	133.8	126.5	N.A.	134.9	−15.3%	−6.3%
Soybeans (mil. bu.)	29.3	29.5	N.A.	65.0	−61.5	−45.7
Wheat (mil. bu.)	129.3	120.2	N.A.	99.9	1.4	−27.7
Rice (rough equivalent, mil. cwt.)	4.0	5.6	N.A.	6.4	14.2	−44.0
Cotton (thou. bales)	554.0	N.A.	N.A.	547.8	−23.2	18.4

Non-Real-Estate Farm Debt Outstanding

	Banks			PCAs[3]		
	Outstanding ($ millions)	Percent Change 6/87 - 6/88	Percent Change 6/86 - 6/88	Outstanding ($ millions)	Percent Change 6/87 - 6/88	Percent Change 6/86 - 6/88
United States	$30,360	−0.2%	−9.2%	$10,127	−4.9%	−20.3%
Eighth District[4]	2,238	−1.8	−16.5	NA	NA	NA
Arkansas	485	3.9	−4.4	183	3.8	−23.1
Kentucky	401	−5.2	−33.3	170	−5.7	−29.9
Missouri	1,038	1.0	−9.5	118	−4.6	−52.8
Tennessee	273	−4.9	−15.9	216	5.0	−11.8

Agricultural Bank Loan Performance[5]

	Percent of Farm Loans Overdue at Agricultural Banks			Percent of Net Loan Losses at Agricultural Banks		
	6/88	6/87	6/86	6/88	6/87	6/86
United States	1.8%	2.7%	3.9%	.31%	.58%	.97%
Eighth District[4]	2.4	3.9	4.3	.16	.42	.60
Arkansas	1.0	2.2	1.7	.07	.22	.39
Kentucky	4.5	4.8	5.4	.24	.34	.44
Missouri	1.9	3.5	3.9	.21	.62	.93
Tennessee	0.7	3.6	1.4	.39	.35	.56

Agricultural Production Loan Interest Rate[6]

	Banks		PCAs	
	8/88	8/87	6/88	6/87
Eighth District Average	10.7%	10.0%	11.0%	11.1%

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[1] The consumer price index components are seasonally adjusted. All other data are not seasonally adjusted.

[2] Percent change from December of previous year, based on the most recent month available.

[3] Source: Farm Credit Banks of Louisville and St. Louis, Farm Credit Administration.

[4] Includes all of AR and parts of IL, IN, KY, MO, MS and TN.

[5] Agricultural banks are defined as those with more than 25 percent of total loans in agricultural loans.

[6] Interest rate data are for different dates. PCA rates are weighted averages for Arkansas and Missouri, not adjusted for stock purchase requirements. Source: Farm Credit Banks of St. Louis.