A *CHOICES* DEBATE: EXPORT SUBSIDIES ON VALUE-ADDED PRODUCTS

Editor's Note:

No one questions the importance of exports of U.S. agricultural products. And, many people favor the use of subsidies in order to enhance their volume.

However, in recent months an important question has arisen as to the advisability of subsidizing "value-added products" (products processed in the United States such as flour), as well as bulk agricultural commodities such as wheat.

Consequently, CHOICES is pleased to include commentary by two individuals who are closely involved in the debate.

One person is Paul B. Green, a consultant to the Millers National Federation and other agricultural processors. He favors the use of export subsidies on value-added products as a trade policy tool.

The other person is Ewen M. Wilson, USDA Assistant Secretary for Economics. He argues that effects of subsidies may differ from policy objectives and that employment effects of subsidized value-added exports may be less than claimed.

CHOICES posed the following question to both individuals:

"Should there be an emphasis on value-added agricultural products in U.S. agricultural export subsidy programs?"

OUR TRADE POLICY NEEDS THEM TOO...

by Paul B. Green

U.S. agricultural export subsidy programs are challenged to serve two masters:

- To bring pressure for rational change in world agricultural trade; *i.e.*, as a trade policy tool.
- To dispose of surpluses and manage stocks; *i.e.*, as a marketing tool. In the face of overcapacity in world agricultural production, pressures build to emphasize the second of these goals.

Resulting policies are then skewed toward bulk commodity exports to obtain the most export tonnage per subsidy dollar. This paper explains why we must never lose sight of the trade policy goal of these programs and, using wheat flour as an example, illustrates why a value-added component of that trade policy is both cost effective and vital to the U.S. economy.

Since World War II, the European Community (EC) has made a conscious effort to dominate the world trade in value-added products through export subsidies. During the 1970s, when U.S. agriculture was concentrating its efforts on the export of corn, wheat, and soybeans, the EC was becoming the largest trader in wheat flour, poultry, vegetable oil, meat, pasta, citrus, malt, wine, and processed vegetables. The EC continues not only to dominate the growing trade in value-added and high-value products through subsidies but also to increase its market shares. EC actions have been particularly severe on the U.S. and other nations that seek to play by the rules. Figures 1 and 2 show the lost market opportunity that is a result of U.S. failure to confront the subsidies over the long term.

The value-added sector is the faster growing market for agricultural products. In the past 14 years, high-value and value-added product trade has risen from $60 billion to $152 billion, and in volume from 150 mmt to 275 mmt. The EC-12 has captured the largest share, not because of any particular comparative advantage, but because of government subsidy actions

Paul B. Green

and the predatory nature of its trade policy. The EC has no monopoly on export subsidies as other nations are using similar techniques to expand their market shares.

Export subsidy practices have drawn protests by competitors under the Subsidies Code of the General Agreement on Tariffs and Trade. However, the GATT has been unsuccessful in ending these unfair practices. If the Uruguay Round of the GATT is to be successful in stopping subsidies, the U.S. must challenge the subsidizing governments for a share of the world market in each of these products and bargain from a

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Paul B. Green is a consultant to the Millers National Federation and other Agricultural Processors.

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position of strength. In other words, U.S. trade policy based on reciprocity, rather than surplus disposal, should be the guiding force in agricultural export programs.

Defense of Trading Rights

In 1983, the U.S. sent a "shot across the bow" of the EC by subsidizing a million-ton flour sale to Egypt. When that program ended, it was not immediately followed by other steps to compete with subsidizing competitors. General aversion to export subsidies and the high budget costs were cited by the U.S. as the reasons for stopping the challenge. The message received by the EC, however, was that the U.S. does not have the long-term resolve to keep up the pressure.

The Export Enhancement Program (EEP) now managed by USDA is a second opportunity for the U.S. to mount an active, sustained challenge to unfair trade practices. This program began in a refined, targeted manner that focused on making U.S. products competitive with subsidized products. The goal of the EEP was to keep pressure on competitor nations to make changes in their subsidies. This would allow comparative advantage to play a part in agricultural trade. Since the EC has targeted processed products, nearly 50 percent of the first year's EEP budget was spent on value-added products.

In 1987, the desire to dispose of the burdensome commodity stocks held by USDA became an overriding criterion. Goals shifted to maximizing the number of tons of product exported per dollar of subsidy cost to USDA. The result was a decided shift in commodities in favor of wheat and barley. Overall expenditures on the program are now nearing $2 billion, and 78 percent of the budget has been spent on these two bulk commodities. Certainly, there is an ongoing need to defend markets for bulk commodities, but not to the exclusion of processed products.

Time To Reevaluate Approach

Because higher subsidies per ton are needed to take strong action in the value-added markets, managers of the programs need to reevaluate the fundamental approach to the subsidy program's implementation. The current view is to place the same economic value on exporting either a ton of wheat or a ton of wheat in the form of flour. Under this premise the flour subsidy should be no more than 1.38 times the wheat subsidy. (It takes 1.38 million tons of wheat to produce 1 million tons of flour).

The problem with this line of reasoning is that it fails to recognize the additional economic activity generated by milling wheat into flour.

Years ago, the EC recognized that the export of value-added products had much larger economic payoffs because of the added economic activity involved--more gross output, more jobs, more corporate income, more personal income, more state and local tax revenues, and more federal tax revenues. Clearly, the EC considers the extra, up-front, subsidy cost justified in order to capture those benefits from the U.S.

Figure 3 shows that the EC has used subsidies on flour since the beginning of the Common Market to increase its share of the world market at the expense of the U.S. They went from supplying 20-25 percent of the world market in 1963 to a share of over 60 percent in 1985-86, without any demonstrat-

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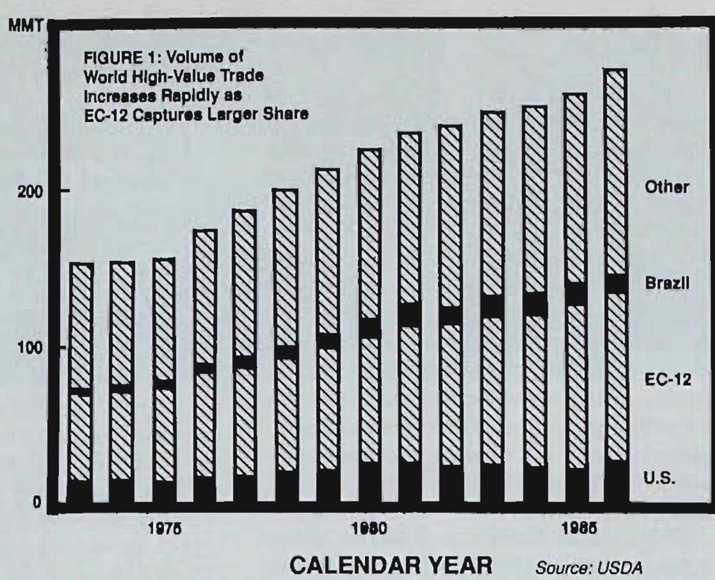
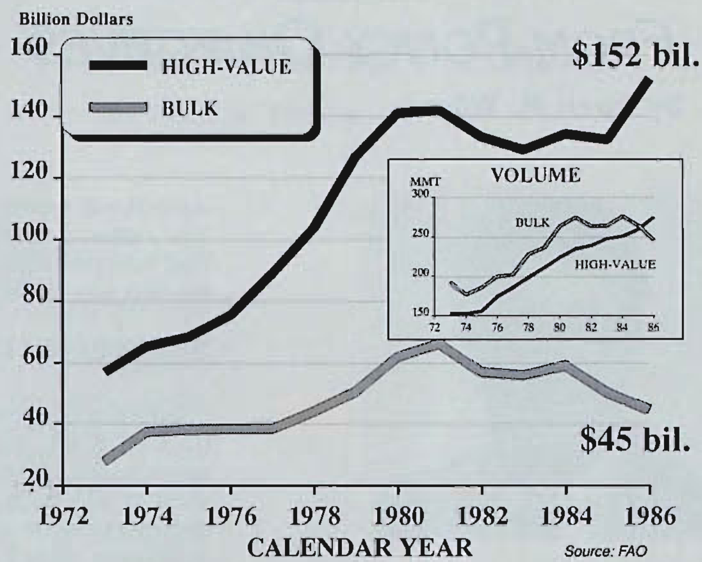
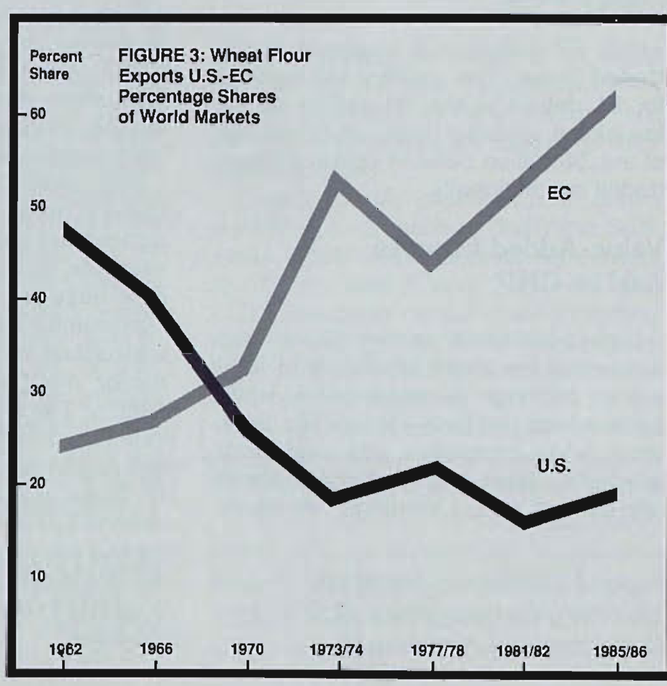


WORLD TRADE IN HIGH-VALUE PRODUCTS AT RECORD LEVELS





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ed comparative advantage in production. This change in market share demonstrates the predatory nature of their subsidy programs. Since U.S. millers cannot compete with EC government treasuries, P.L. 480 food aid programs have been the mainstay of any U.S. presence in world flour markets over that 25-year period.

Cost Effectiveness

USDA can also recognize the value-added benefits in the management of export programs. Because subsidies represent a government expense, the best way to measure value received is from the tax revenue paybacks. The difference between subsidy cost and tax revenue paybacks results in a net treasury impact for subsidized exports. ERS-USDA developed a way to guage tax revenue paybacks for individual commodities (and their processed products) by a measurement device called "tax multipliers." In effect, the multipliers measure the amount of corporate and personal income taxes generated by the export of specific products (a multiplier of .5 indicates $.50 of taxes are generated by every $1.00 of export value of the commodity). The estimated multiplier for bulk wheat is .225. For flour it is .558.

Calculation of the tax revenue payback for any products consists of multiplying the value of the bulk commodity times its tax multiplier and then times the conversion factor (if any). Depending on the tax multipliers, an individual subsidy can have either positive or negative net treasury impact.

Ewen Wilson's table calculates the relative subsidy levels at which tax revenue paybacks offset the subsidies paid (budget neutrality). The chart shows that the net cost to the Treasury (if any) is far less than the initial subsidy. For example, if wheat is $3.50/bu., a ton of wheat exports leads to $30 of U.S. tax revenues while a ton of flour generates $99 of federal taxes. Average subsidy costs in EEP reflect these considerations. They have approximated $90.00/mt. for flour and $35.00 for wheat. Calculation of the exact tax revenue payback on each sale or the decimal-place accuracy of the multipliers is not the issue. The important point is that a large portion of the subsidy dollar is offset by the tax revenues generated by the new economic activity.

In addition to trade policy considerations, it is reasonable for managers of U.S. trade policy to weigh the costs of subsidies on individual products as part of their decisionmaking process. The flaw in the current system is that those managers are only responsible for the up-front budgetary outlays by USDA. If that budget management system also reflected the net treasury effects of taxes created by new exports, a more accurate view of costs would occur. *On a true-cost basis, value-added trade policy is shown to be no more expensive than trade action in bulk commodities.*

Two other arguments are made regarding the economics of subsidizing value-added products:

• Lest one is tempted to take the multiplier arguments to their extremes; no one proposes replacing all U.S. bulk exports with value-added products. Nor is anyone advocating subsidies on consumer-ready foods. The world markets for wheat and flour are as distinct and unique as the markets for poultry and feed, barley and malt, or oilseeds and refined oil. There is no substitution and it is not an either/or question in the export commodity mix. The processed forms of these products are traded in significant volumes in the world and can provide U.S. agriculture with new sales outlets for the raw products.

U.S. Processors Not At Capacity

• Some argue that mounting a countervailing subsidy program in value-added could give the incentive to build new unjustified processing capacity. Indeed, economists have shown that subsidies in an industry that is at full capacity breed new non-economically viable production. The EC has ample evidence of this as well: tremendous agricultural processing capacity built solely to capture the export subsidy payments. However, to propose not defending U.S. farmers and processors' trading rights for fear of creating new capacity based on artificial incentives is the opposite of the actual situation.

U.S. processors are as efficient as any in the world and could compete, in the absence of subsidies, in world markets for nearly every processed agriculture product. However, the productive capacity that could compete lies idle because of foreign government actions. Over time, competitive processing facilities in the U.S. are mothballed or cannibalized due to the unfair trade practices. Obviously, if free markets are restored, those facilities cannot be restored at competitive costs and U.S. firms would not invest in new facilities which would still be at risk to any restoration of such predatory practices. Therefore, the U.S. economy and our goal of competitive free markets has much to lose from a lack of strong action.

The Export Enhancement Program and other trade policy export subsidy programs of the United States should be managed in a manner that keeps the maximum amount of pressure on the foreign GATT negotiators and budgets of subsidizing competitors. That means a broad range of bulk and processed products must be targeted.

It may be possible to achieve our goal of free and open trade in agriculture commodities and their products in GATT, but not if competitive, efficient industries are sacrificed before the talks reach fruition. C