

THE HISTORICAL CASE FOR INTERNATIONAL COMMODITY AGREEMENTS

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As the Reagan administration mounts an offensive to place agricultural price support and subsidy programs on the chopping block, many farm groups are joining together in a campaign to strengthen the farm program. In the contest, the White House is usually portrayed as the noble champion of free trade while the farm groups are described as entrenched, parochial interests committed to protection. Upon closer examination, however, the conventional labels lose their meaning.

To be sure, at international trade meetings, the President's representatives are taking the lead calling for the eventual abolition of agricultural subsidies at home and abroad. At the May 1987 ministerial meeting of the Office of Economic Cooperation and Development, the U.S. persuaded the member nations to agree that the "long-term objective is to allow market signals to influence by way of a progressive and concerted reduction of agricultural support...." The U.S. also intends to pursue its objective of reducing agricultural subsidies at the forthcoming round of negotiations under the auspices of the General Agreement on Tariffs and Trade.

While posing as a staunch defender of free trade at international forums, the Reagan administration has taken the opposite position at home. The President initiated a U.S. agricultural trade policy based on cutthroat price competition, higher cash subsidies to producers and the expanded use of export subsidies. Such a unilateral policy has antagonized other exporting nations, making it clear to them that the U.S. commitment to free trade is secondary to the expansion of U.S. agricultural exports at any price and to domestic political considerations.

Failure of the 1985 Farm Bill

When U.S. agricultural exports began declining in the 1980s, agribusiness and the grain trade lobbied Congress to enact a "market-oriented" farm program, claiming that U.S. farm products would be more competitive in world markets if the price support levels were cut. Under the 1985 farm bill, the price support loan rates have been steadily reduced. Target prices, on the other hand, were not cut initially, thus increasing the cash subsidies to producers, and the reductions slated for the next several years are of less magnitude than the cuts in the loan rates. This means deficiency payment subsidies to producers will remain relatively high.

In addition to the annual reductions in the loan rates, the 1985 farm bill also included provisions for marketing loans for rice and cotton. The marketing loans allow producers to pay off their rice and cotton loans at the lower world market prices instead of having to repay the full amount of the loan received from the government when the crop was placed in storage. The marketing loans thus undercut the price support loan rates, driving market prices down to supposedly competitive levels while increasing subsidy payments to producers.

Contrary to the expectations of those promoting a "market-oriented" farm program, cutting the loan rates did not make U.S. farm products significantly more competitive in world markets. The promoters failed to recognize that changing market conditions had reduced the responsiveness of export markets to price changes. The surplus capacity and high stock levels that have developed in many countries and the loss of purchasing power caused by worldwide recession and high debt levels in developing nations made it much more difficult to capture new export markets even at lower prices.

The marketing loan approach also illustrates the futility of attempting to obtain export markets through price pressure alone. According to projections by the Food and Agricultural Policy Research Institute (FAPRI), based at the University of Missouri and Iowa State, with a marketing loan in effect rice exports will increase by an annual average of 3% between 1987 and 1995, but cotton exports will show no significant gain. The lower rice and cotton prices under the marketing loan will reduce the average annual value of rice and cotton exports to less than the

level of the early 1980s. The average annual unit value of rice exports between 1987 and 1995 falls to 57% less than the level of the early 1980s, while the unit value for cotton drops by 16%.

With lower commodity prices and a slack export market, FAPRI projects a steady decline in net farm income over the next several years if the current farm program remains in effect. Even though subsidies comprise a sizeable portion of net farm income, the payments are insufficient to restore profitability to agriculture. Between 1987 and 1991, FAPRI's analysis indicates that net farm income will fall by 25% and the decline continues in subsequent years. Under these circumstances, the farm financial crisis will intensify in the coming years.

Cut-throat Pricing and Trade Disruption

The 1985 farm bill not only is wreaking havoc among U.S. producers, but also threatens to disrupt world agricultural trade. The Office of Economic Cooperation and Development recently warned that "the escalation of the search at any price for export outlets is dangerously increasing tensions in world trade." In response to cuts in the U.S. corn loan rate, Canada recently imposed a duty on U.S. corn imports in order to protect Canadian corn growers. Thailand, a major rice exporter, has strongly protested U.S. rice subsidies as being predatory while cotton-exporting developing nations are bearing the brunt of low U.S. cotton prices. As economist D. Gale Johnson observed, "the United States has shown no reluctance in using the power of its treasury to force U.S. products into world markets at low prices." The U.S. reliance on subsidies, Johnson concluded, "will continue to cause disorganization and depression in world markets."

From its analysis of the longer-term impact of the 1985 farm bill, FAPRI recognizes that export growth will be slower than anticipated because of reduced global purchasing power and higher worldwide stocks of farm products. Current stock levels and the continued adoption of yield-increasing technology by other countries, FAPRI says, "clearly indicate that export markets are not the full answer to U.S. excess capacity problem." Substantial export growth, FAPRI concluded, "can only come from negotiated policy changes in important existing markets or more rapid growth in developing country economies, which are the major source of growth in future markets."

The latter option is remote, however, given the high debt levels of developing nations and their limited capacity to pay the obligations. As U.S. policies drive world commodity prices down, the agricultural export earnings of developing nations are reduced, thereby depriving them of the foreign exchange needed either to pay debt or to purchase more U.S. agricultural products. Ironically, instead of expanding export markets, the U.S. policy of cutting commodity prices is undermining potential markets in developing nations for U.S. farm exports.

With no quick fixes available to expand export markets, a negotiated expansion of trade remains the only option to consider. The Reagan administration's negotiating stance in international forums focuses on eliminating agricultural price supports and subsidies in order to expand world trade in farm products. Critics of the Reagan position, both at home and abroad, suggest that abolishing agricultural support programs will lead to a further collapse in commodity prices, to trade disruption, and to a deeper agricultural depression.

Family Farm Act

A different approach to international agricultural trade negotiations is embodied in the Family Farm Act (S. 658/H.R. 1425) introduced by Sen. Thomas Harkin and Rep. Richard Gephardt. The bill requires the President to initiate negotiations for a multilateral trade agreement with

exporting nations. The parties to the agreement would seek an accord on establishing prices, on preserving export market shares and on assigning production cutbacks equitably among nations. The bill also provides for the expansion of consumption through improved food aid programs at home and abroad. If other exporting countries decline to participate in the negotiations, the bill then authorizes the U.S. to subsidize exports in order to maintain market shares.

The Family Farm Act included a provision for an international agricultural trade agreement in order to coordinate U.S. farm policy with that of other exporting nations. Under the bill, price floors for U.S. farm products would be established by setting the commodity loan rates at 70% of parity and annually adjusting them upward until the price floors reach 80% of parity. The cash subsidies to producers under the target price program would be abolished, thereby eliminating a major source of contention with other exporting nations which view U.S. producer subsidies as unfair trade practices. To balance supply and demand at the higher price levels, the bill authorizes mandatory production controls subject to producer approval in a nationwide referendum. To prevent other exporting nations from obtaining an unfair price advantage against the U.S. 70% of parity price level, the bill mandates the negotiation of an international agricultural trade agreement.

In evaluating the Family Farm Act, FAPRI underscores its belief that only an international agreement on prices and market shares would enable the U.S. to remain competitive in world markets. This assumption is debatable. If the U.S. established higher commodity prices for its farm products, other exporting countries have indicated that they will raise their prices as well. A large gap between U.S. prices at 70% of parity and the lower world prices at the current depressed level of less than 50% of parity therefore will not exist.

The provision for a multilateral trade agreement, nevertheless, provides insurance that U.S. price levels, exports and market shares will be maintained. From FAPRI's perspective, "the critical assumption is the market-sharing cartel [multilateral trade agreement] among the exporting countries." Without an international agreement to safeguard export markets, FAPRI sees only two options for the U.S.: either drastically cut production and produce only for a domestic market or resort to expensive export subsidies. The success of the Family Farm Act therefore hinges on the market-sharing cartel, according to FAPRI's analysis. The prospects for implementation, however, are dim. "There is serious doubt by many analysts that it will be possible to organize and enforce the cartel," FAPRI stated.

The doubts about the workability of a multilateral trade agreement on commodity prices and market shares reflect both the free traders' opposition and the prevailing perception that such an approach cannot be sustained over the long-term. Free traders regard the marketplace as the only legitimate mechanism to establish commodity prices and market shares. Administratively setting prices and shares through international agreements they believe will foster inefficient, high-cost production insulated from the rigors of price competition in the marketplace. Other analysts question whether countries participating in a multilateral trade agreement would be able to adhere to the pact over a long period of time, particularly if national economic and political pressures militate toward abandoning the accord.

Rationale for International Commodity Agreements

Despite the skepticism, a solid case may be made for negotiating a multilateral agricultural agreement. The rationale for such an approach was first developed by the U.S. Department of Agriculture (USDA) during World War II. At that time, the State Department was pursuing its plans for a postwar commercial policy of expanding world commerce by eliminating barriers to trade, including agricultural price support programs. USDA's office of Foreign Agricultural Relations (OFAR), now known as the Foreign Agricultural Service, attempted to resolve the

conflict between the State Department's international economic goals and the domestic reality that Congress had enacted a farm program with price supports established at 90% of parity. From its experience and economic analysis, OFAR concluded that international commodity agreements would enable the U.S. to continue its trade liberalization policy without sacrificing the economic interests of farmers in the process.

OFAR cited two major problems with the State Department's proposal for a postwar commercial policy of reducing barriers to trade. First, the policy was politically unrealistic. The experience of depression and war had led governments to take a more active role in managing national economies and trade policies. Such intervention, OFAR believed, was not likely to be rapidly abandoned after the war, no matter how fervently the State Department preached the gospel of liberalized trade. Second, the State Department's policy was economically unsound. According to OFAR's analysis, surplus conditions would return in the postwar period and short-term demand would slacken because of the reduced purchasing power in war-torn importing countries. Under such circumstances, throwing stocks on the market in the name of liberalized trade could cause a price collapse, OFAR warned, "from which it may take years to recover" and which might be a "contributing factor to a world economic depression."

The reservations expressed by OFAR were based on its exhaustive, long-term analysis of world commodity markets. The task was a natural one for OFAR because its function within USDA was to provide information on foreign markets. The research led OFAR to several key conclusions: domestic price support programs are an economic necessity but need to be coordinated internationally; free trade theory is flawed when applied to agricultural production and trade; and international commodity agreements will promote the expansion of agricultural trade without fostering inefficient production.

Need for Price Supports

Instead of condemning governmental intervention in agriculture as the free traders did, OFAR defined "a basic need for government aid to agriculture resulting from differences between agriculture and other aspects of the national and world economy." Because of the nature of agricultural production, farmers could not adjust to changing market conditions as readily as manufacturers. When demand increased, as in World War I and again in World War II, farmers expanded production rapidly, but they could not easily cut production when demand slackened as it did during the interwar years.

The Depression of the 1930s had revealed that even when a substantial decline occurred in demand, in per unit commodity prices, and in general economic activity, agricultural production tends to be maintained. Agricultural production cycles and limited options (such as acreage, capital, climate and soil constraints) prevented farmers from rapidly shifting their production plans if the prices for a particular commodity began to fall. At times, as during the Depression, any shift at all proved to be futile when prices for almost all commodities entered a general decline. Farmers had few choices but to keep on producing in the short run (even trying to increase production in order to improve their marginal returns).

Before farmers could undertake adequate production adjustments, supply usually outstripped demand and caused prices to plummet, thus resulting in "economic distress in the field of agriculture which eventually spreads to other sections of the economy." To OFAR's way of thinking, governmental intervention to help stabilize the prices and supplies of agricultural commodities therefore became a necessity.

Efforts by nations to provide income and price support incentives for the expansion of

agricultural production held one danger in OFAR's view. Countries that encouraged high-cost production of farm products would eventually find themselves in a surplus situation, which probably would result in an international trade war for export markets. Cutthroat price competition would ensue, resulting in "disastrously low prices for exporting countries." The solution on an individual country basis was to adopt production controls instead of providing price support on unrestricted output. But a country would be reluctant to cut back production if doing so meant losing export market shares as well. Attempts by individual countries to improve the situation had been ineffective in the past, leading OFAR to endorse international commodity agreements as a practical approach to "orderly marketing" in world agricultural trade.

In countering OFAR's position, the free traders in the State Department insisted upon price competition in the marketplace as the proper tool "for achieving a pattern of world production corresponding, as nearly as possible, to the principle of comparative advantage." The only method to squeeze out inefficient producers, according to free trade logic, was to expose them "to the withering effects of competitive prices." OFAR agreed, but only to a point where competitive prices remained "consistent with the maintenance of a reasonable general level of economic activity." Allowing market prices to slump drastically and to disrupt the economy was "defeatism," OFAR maintained, adding that in "the type of increasing-cost enterprise that characterizes agriculture, the low prices do not 'wither' the high-cost producer; they 'wither' a good part of the rest of the economy first."

The State Department disagreed, stating that governmental intervention would render the marketplace concept of comparative advantage meaningless. OFAR responded by noting that free trade had been gradually losing its objective luster "ever since monopolistic elements became important in the pricing process...." The proper context in which to redefine comparative advantage in agricultural trade, OFAR argued, was in connection with commodity agreements.

Flaws in Free Trade Theory

From its analysis OFAR also revealed that free trade theory did not fully apply to real world situations involving the production and marketing of farm products. Free traders assumed that commodity price changes in the marketplace, unprotected by price supports, would lead to adequate production adjustments. But if the production response tended to be "slow and inadequate," as in the case of farm products, simply reducing barriers to trade could not "be relied upon to accomplish the required adjustment."

Free traders also assumed that economic prosperity would prevail in the real world, allowing a satisfactory level of consumer purchasing power and opportunities for high-cost producers to shift production or to obtain alternative employment. Attempting to relax agricultural trade barriers in the absence of a prosperous world economy, however, spelled serious trouble for agriculture because of inherent rigidities in its ability to shift production in response to declining prices. Pure market forces, therefore, "neither prevent depressions nor cure them quickly," OFAR observed.

Role of International Commodity Agreements

To compensate for the shortcomings of free trade theory, OFAR recommended the negotiation of international commodity agreements. Although State Department officials feared that agricultural pressure groups would use commodity agreements to "foist more inefficiency on society," OFAR believed that international cooperation would help reduce the uneconomic production fostered by various national agricultural support programs. Failure to establish "intergovernmental arrangements" for the "rationalization of production," OFAR warned, probably would result in another price-depressing commodities glut and in economic disruption

because postwar demand still would not be adequate to absorb expected supplies. Commodity agreements, on the other hand, served as a means to equitably distribute export market shares, to establish prices fair to both exporter and importer, to regulate reserve stocks, and to maintain production controls designed to balance with supply and demand.

OFAR's concept of international commodity agreements went beyond the rudimentary commodity accords negotiated before World War II. The early accords were not concluded under any general international agreement. They usually ignored consumer representation and were not oriented toward expanding consumption. Because the commodity agreements of the 1930s were established during a period of sharply reduced consumer purchasing power and of burdensome commodity stock levels, their primary goal was to reduce production. This led free trade critics to view the early commodity agreements as restrictionist-oriented cartels, which would encourage increasing use of governmental controls.

For the postwar period, however, OFAR sought a new kind of international commodity collaboration, which would foster the orderly expansion of production rather than being exclusively restrictionist. While OFAR's proposal for commodity agreements included provisions for production controls in exporting countries, restricting supply was not the sole focus. OFAR wanted the postwar agreements to include both producing and consuming countries and to be "directed toward an expansion in world trade and consumption." By bringing importing countries into the agreements, OFAR intended to also incorporate issues related to consumption. The postwar agreements were to include provisions for expanding consumption, improving nutrition and finding new outlets for surpluses, such as food aid programs for low income groups at home and abroad.

For both exporting and importing nations, international commodity agreements promised to stabilize the historically erratic international trade in agricultural products by maintaining "a reasonable volume of exports at reasonable prices." Through such agreements, exporting countries would be able "to obtain a reasonable share of such world markets as exist and to obtain this share at prices above those that would prevail in the case of unrestricted competition." Believing that the policy of reducing barriers to trade would be more likely to disrupt world agricultural trade than to expand it, OFAR flatly stated that international commodity agreements were "the only practical way in which to bring about a balanced worldwide expansion in production trade and consumption of agricultural products."

Through international commodity agreements, OFAR sought to coordinate national price support programs. OFAR believed international coordination would restrain the tendency for commodity programs to become restrictive and for governmental intervention to perpetuate and extend itself. Under the guidance of international commodity agreements, producer and consumer nations could arrive at a mutually acceptable set of principles related to fair price levels, market shares, reserve stocks and the expansion of consumption. Under the agreements, principles also could be established to keep interventionist programs from becoming restrictionist and to determine conditions for the withdrawal of such programs once the maladjustment necessitating their use had been corrected.

OFAR's support of international commodity agreements did not imply a wholesale condemnation of free trade policy. Rather, OFAR simply pointed out that the assumptions behind free trade theory did not fully apply to agriculture. To force a free trade policy on agricultural production and trade, OFAR repeatedly emphasized, would lead to surpluses and to trade wars. OFAR was arguing that in those areas of the economy where free trade applied, production and trade policy should permit "the maximum feasible use of competitive forces for the integration of future advances in technology into the world's economy." At the same time, OFAR advocated "the use of internationally coordinated intervention to maintain and expand

activity in those areas of the economy [such as agriculture] which otherwise would be sources of disturbance and depression.”

In summary, OFAR’s position was that free traders should acknowledge the economic basis for not fully exposing agriculture to free market conditions. Supply and demand functioned imperfectly when applied to agriculture because of the physical constraints, which prevented farmers from—responding rapidly to changing market conditions. Under a free trade system, the inability to readily shift production in response to declining demand led to periodic price-depressing surpluses, which threatened the economic well being of both inefficient and efficient producers, thus rendering the principle of comparative advantage useless under such circumstances.

By the same token, OFAR wanted the proponents of national-oriented price support programs to acknowledge the international arena in which they operated and to guard against stimulating uneconomic production which probably would lead to a renewed round of trade wars. In OFAR’s estimation, price support programs were not a substitute for the role played by the free market’s price mechanism in determining production levels, but ought to serve as a buffer against the extreme price and supply fluctuations caused by the imperfect manner in which free trade applied to agricultural production and trade. By coordinating price support programs through international commodity agreements, a stable level of economic activity could be maintained, OFAR believed, providing a solid foundation to increase consumption and to expand world trade.

Real Reason Behind State Department Opposition

The State Department refused to accept OFAR’s rationale, claiming that any form of government intervention conflicted with the free trade goal of promoting low-cost, efficient production. In the negotiations for a postwar commercial policy the State Department “assumed as a starting point, that a worldwide reduction in trade barriers and a consequent expansion in international trade [were] essential to an expanding world economy and the maintenance of world peace.

Behind the State Department’s lofty rationale for pursuing a policy of trade barrier reduction was the more pressing issue of national self-interest. As the recession of 1938 had painfully revealed, the New Deal failed to solve the problem of unemployment in peacetime. Memories of the depression following World War I raised fears of a similar economic disruption in the wake of victory over the Axis powers. Increased access to foreign markets, freer trade, therefore seemed the only way to avoid economic stagnation, labor unrest and more government intervention in the economy.

One of the State Department’s chief free trade theorists saw apocalypse around the corner if the U.S. abandoned the policy of trade barrier reduction. “If we were to drop our trade program,” he said, “we should risk our international leadership, our foreign trade, our system of private enterprise. We should also imperil our national security.”

Although it harbored free traders in its midst, the State Department never intended to pursue a policy of perfect free trade. As economic historians Joyce and Gabriel Kolko have argued, “in the long run perfect free trade in the world economy would hurt the United States far more than it helped it, for European states would again trade with each other, restore their power in the world economy and Third World, and inevitably challenge America’s supremacy even in its domestic market.” To capture foreign markets for U.S. exports, the State Department ignored the free traders and instead pursued a policy of creating “artificial demand” through the use of loans and grants to tie foreign economies to that of the U.S. From such an interventionist policy came the Marshall Plan, economic assistance programs to developing nations and military assistance

programs.

The State Department relied on its free trade theorists to provide the camouflage to cover its nationalistic trade expansion policy in the rhetoric of free trade. Although seeming to give great credibility to its free traders, the State Department merely found them convenient to have around for public relations purposes. The real power in the State Department was wielded by those representing importers of raw materials and exporters of manufactured goods, of agricultural commodities and of capital. The importers wanted access to cheap commodities and they regarded international commodity agreements, which would raise and stabilize farm product prices, as a distinct threat. The exporters were desperate to expand export markets in order to prevent surplus capacity from leading to another depression and they feared that international commodity agreements would restrict export expansion. The importing and exporting interests relied on the free trade theorists to develop a trade expansion rationale which, though based on the rhetoric of free trade, would allow the U.S., the nation with the strongest postwar economy, to dominate world commerce.

By the end of World War II, it became evident that OFAR could not match the influence of the State Department in the White House. Although OFAR had built a solid case for international commodity agreements, the importing and exporting interests in the State Department ultimately rejected the approach, arguing that it conflicted with free trade. In reality, the importers and exporters wanted access to cheap commodities and to export markets at any price in order to increase the profits of the private firms they represented.

The self-serving nature of the State Department's opposition to international commodity agreements became clear in trade discussions with Latin American nations. The one inter-American commodity agreement in force was the coffee agreement negotiated in 1940. In 1944, the State Department vetoed the request from Latin America coffee producers for higher prices. The following year, during negotiations to renew the agreement, the State Department opposed the quota provisions, which allotted quantitative shares of the U.S. market to each coffee producing nation. Without quotas, the agreement was meaningless because the producing nations then would have to return to cutthroat competition against each other, driving prices down and leading to market instability. After bitter debate, the coffee agreement was extended without quotas until 1946.

At the foreign ministers conference of American nations held in Mexico City in 1945, the Latin American foreign ministers responded to the assault on the coffee agreement by pressing for permanent commodity agreements for the stabilization of Inter-American trade in raw materials—the position OFAR had taken. The U.S., however, refused to accept permanent commodity agreements and would acknowledge their use only as “temporary expedients.” With regard to the coffee agreement, when it expired in 1946 little remained but the form. The U.S. opposed the quotas, the stabilizing feature, and used the agreement to keep a lid on coffee prices. The State Department's distortion of the coffee agreement was far a field from the purpose of commodity agreements as envisioned by OFAR.

Learning from the Past

Today's efforts to stabilize commodity markets at prices more remunerative to producers have met the same resistance as OFAR encountered from the free traders and the importing and exporting interests in the State Department during the 1940s. The Reagan administration, agribusiness and the grain trade employ the same free trade rhetoric to oppose the proposed Family Farm Act which would establish higher floor prices and a mandatory supply management program as well as provisions for the negotiation of international commodity agreements. As during World War II, the free trade argument is largely self-serving for corporate interests, like

the grain trade, which stand to profit from market instability.

During the 1985 farm bill debate, grain trade lobbyists argued that cutting price support levels would lead to export expansion and higher farm income. Congress jumped on the bandwagon and passed the so-called “market-oriented” 1985 farm bill. The program failed to expand exports and resulted in lower farm income, thus aggravating the farm financial crisis. Instead of demanding a rigorous analysis of the market-oriented approach, Congress simply accepted the grain trade’s rosy forecast. That was a mistake, FAPRI points out, because “International markets were expected to respond to reductions in prices on the basis of very frail empirical evidence.”

The bitter reality of a continuing depression in agriculture, made worse by the 1985 farm bill, suggests that Congress needs to move vigorously to question the economic assumptions embedded in the grain trade’s free trade rhetoric. A good basis for reevaluation would be the analysis developed by OFAR four decades ago, making the case that price supports are necessary buffers against wide swings in commodity prices and that the coordination of domestic farm programs through international commodity agreements will result in a balanced expansion of trade at fair price levels for producers and consumers.