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THE EFFECTS OF THE THIRD WORLD DEBT CRISIS ON U.S. AGRICULTURE

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED FIRST CONGRESS

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THURSDAY, MAY 18, 1989

THE EFFECTS OF THE THIRD WORLD DEBT CRISIS ON U.S. AGRICULTURE

THURSDAY, MAY 18, 1989

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to notice, at 2:08 p.m., in room 2359, Rayburn House Office Building, Hon. Lee H. Hamilton (chairman of the committee) presiding.

Present: Representatives Hamilton, Upton, and Jontz.

Also present: Joseph J. Minarik, executive director; and David Freshwater, professional staff member.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, CHAIRMAN

Representative HAMILTON. The meeting will come to order. Today we will be looking at the relationship between Third World debt, particularly between Latin America and the condition of U.S. agriculture. Latin America is a major export market for the United States, but our sales to the region have been adversely affected by their debt burden. In addition, the southern-most countries in the region are important agricultural exporters of commodities which we, too, export.

So, two important issues for U.S. agriculture are how do we recover lost Latin export markets and how can we reconcile the need of Latin exporters to sell in other markets with our need to increase exports sales?

The Joint Economic Committee will hear from three distinguished witnesses on these issues. Robert Paarlberg is a visiting professor of government at Harvard University and an expert on agricultural trade policy and international development.

George Rossmiller is the director of the National Center for Food and Agricultural Policy at Resources for the Future here in Washington. He is well versed in domestic agricultural policy and the GATT negotiations.

G. Edward Schuh is the dean of the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota and is well known for his work on the effects of macroeconomic policy on agriculture and international agricultural development. We are very fortunate to have each of you here. Your prepared statements, of course, will be entered into the record in full. We have asked that you keep your opening comments brief, and then we will turn to the questions.

Mr. Paarlberg, you may proceed.

STATEMENT OF ROBERT PAARLBERG, VISITING PROFESSOR, DEPARTMENT OF GOVERNMENT, HARVARD UNIVERSITY

Mr. PAARLBERG. Thank you, Mr. Chairman.

What I would like to provide is a note of caution to your question. The question before us is what has the debt crisis done to damage the total value of U.S. agricultural exports, especially to Latin America so far in the 1980's and what could a resolution to that debt crisis do to revive U.S. agricultural exports, especially to Latin America in the 1990's? The conventional answer among trade optimists is to say that the debt crisis hurt a lot in the 1980's and a resolution to the crisis would help a lot in the 1990's.

I also consider myself to be a trade optimist, but my review of the evidence in Latin America leads me to suspect that this debt crisis isn't the only factor, perhaps not even the most decisive factor, constraining U.S. agricultural sales to that region.

In my prepared statement, I list a number of other uniquely Latin American characteristics, both supply-side and demand-side characteristics, which help to explain why U.S. agricultural sales have lagged in the past and why they may continue to lag in the future, even without the debt crisis.

The most important of these are, first, Latin America's huge supply-side potential to produce temperature zone agricultural commodities, things like wheat, coarse grains, soybeans, meat products, at times in competition with the United States; and, perhaps as important, Latin America's limited demand-side potential as a food consuming region because of unjust and inequitable social and political structures which tend to keep the income records from growth out of the hands of the underfed poor majority.

But with this pessimistic view of Latin America in mind how can I account for the undeniable fact that in the 1970's and right up through 1981, Latin America was a significant growth market for U.S. agricultural exports? And how can I account for the fact that Latin America then ceased to be a market for U.S. agricultural exports after 1981, precisely at the time debt service burdens began to be felt?

There are four reasons, I believe, why it would be unsafe to conclude from this trade history of the 1970's and the 1980's that a debt-free Latin America in the 1990's would provide a substantial growth market for U.S. agriculture.

The first of these reasons: Almost half of the U.S. sales growth that took place in Latin America between 1973 and 1981 took place in only one country—in Mexico. And much of this strong growth in Mexico agricultural imports was a temporary result of much higher Mexican foreign exchange earnings from the export of temporarily high-priced oil.

Mexico is unlikely, any time soon, to enjoy a replay of this oil price-related export earnings windfall. In any case, I am not sure that the U.S. economy or even U.S. farmers would want the suddenly higher energy prices that would be the necessary precondition for such a Mexican windfall.

Second, much of the rest of the growth that took place in U.S. agricultural sales to Latin America took place in just two calendar years: 1980 and 1981. This market growth was attributable to another purely temporary event and also one which I suspect most of us would not want to repeat; namely, the 1980–81 U.S. embargo on grain sales to the Soviet Union.

You will recall that when the U.S. temporarily stopped selling to the Soviet Union because of their Afghanistan invasion, a number of other non-U.S. exporters, including Argentina, couldn't resist the temptation to sell more of their own grain to the Soviets at premium prices. In order to do so, of course, they had to stop selling grain to some of their traditional Latin American customers, especially in the Andean region. These abandoned Latin customers in 1980 and 1981 quite naturally turned, temporarily, to the United States which had plenty of embargoed grain to sell.

Third, when the debt crisis did begin to constrain Latin imports after 1981, it is of interest that agricultural imports, at least from the United States, were not at first so seriously affected. Between 1981 and 1984, the dollar value of U.S. agricultural sales to Latin America fell by only 17 percent, this at a time when total Latin imports of all goods, including nonagricultural goods, were falling twice as fast. Latin imports of agricultural products were relatively immune from debt crisis constraints, first, because the United States was providing generous financing to its agricultural trade with Latin America during this early debt crisis period and, second, because Latin America's agricultural imports were only a small share of total Latin American imports, only about 11 percent in 1982, and hence relatively easy to sustain, while other less essential imports were being cut back.

Debt service burdens, in other words, are not always the dominant variable in the agricultural import equation. One little-noted USDA analysis done back in 1985 indicates that world market price constraints, combined with indigenous Latin American farm production constraints, together are more than twice as important as debt service constraints in determining variations in U.S. agricultural sales to Latin America.

Fourth and finally, the farm trade decline that did occur after 1981 wasn't necessarily a sign of vast market potential in a debt-free Latin America, because the debt crisis didn't suddenly begin in 1981. It isn't just the decline in U.S. sales after 1981 that should be attributed to that crisis; it is also a part of the earlier rise of U.S. sales to Latin America prior to 1981. This rise in sales in the 1970's was in part a result of the unsustainable foreign borrowing by Latin governments in the late 1970's which created the debt crisis in the first place.

This is a point we sometime miss. The only way for U.S. farm exporters to get back on a steep trajectory of rapidly growing exports to Latin America, the trajectory that they were briefly on in the 1970's and the early 1980's, would be to return to a pattern of unsustainable Latin borrowing, of the kind that got us into the debt crisis in the first place.

Well, what do I conclude from this brief analysis? I don't wish to imply that the debt crisis in Latin America is unimportant to U.S. agriculture. There is no doubt, in the absence of this debt crisis, U.S. farm sales to Latin America would be larger than they are today. But those of us who want to ease this crisis shouldn't rest too much of our case on the problematic farm trade connection. There are plenty of other reasons, mostly linked to the future welfare and political stability of Latin America itself, why we should seek to relieve today's crushing burdens of unserviceable foreign debts.

Thank you very much.

[The prepared statement of Mr. Paarlberg follows:]

PREPARED STATEMENT OF ROBERT PAARLBERG

Future U.S. Agricultural Exports to Latin America: A Realistic Appraisal

As a word of introduction, Mr. Chairman, I am an independent scholar with an interest in U.S. agricultural trade. This interest has prompted me, often in the past, to argue that U.S. agricultual exporters have reason to be optimistic about their future -- because of the large potential demand for U.S. agricultural products that exists in the developing world. In the developed world, where population growth has nearly stopped and where diets are already rich, the potential is limited. But in the developing countries, where population growth remains high and where diets have much room to improve, there is enormous potential for future export market growth.

Whenever I try to make this optimistic argument in front of knowledgeable U.S. farm groups, however, I have to be careful. I can apply this argument confidently to most of the developing countries of Asia (especially the Pacific Rim), and also to developing countries in North Africa and the Middle East. Here, even during the difficult decade of the 1980's, diets have been enriched and agricultural imports have grown. But I have to hedge the argument when I come to Latin America. During the decade of the 1980's, Latin farm imports did not grow. They actually declined by more than 30 percent.[1]

It has become something of a convention, here in Washington, to attribute all of this disappointing import decline to just one cause -- the Latin American debt crisis. I do not deny that the debt crisis has played a role, and I do not deny that U.S. farm exports would profit from an easing of that crisis. But the magnitude of the export gains to U.S. farmers that might accompany an end to the debt crisis should not be exaggerated (I have recently seen estimates as high as $3 billion). In the time that I have, Mr. Chairman, I would like to suggest why the agricultural trade gains might actually be much less than that.

Large Supply Side Potential

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1. Agricultural imports from the U.S., specifically, declined by nearly one half between 1981 and 1987. Back in 1981, the U.S. enjoyed a $100 million agricultural trade surplus with Brazil, Mexico, Argentina, Venezuela, and Chile. By 1986, with these same five countries, the U.S. had a $2.3 billion agricultural trade deficit.

First, on the supply side, Latin America differs from the rest of the developing world because of its unique resource endowments for agricultural production. Nowhere else in the developing world can we find so much land so well suited to the production of temperate zone farm commodities -- wheat, coarse grains, oilseeds, and livestock products, all of the kind that can displace imports from the U.S.. Elsewhere in the developing world -- from the over-crowded rice lands of Asia to the arid deserts ot North Africa and the Middle East -- when development takes place and brings higher income, and when that income is then spent to enrich the diet with animal products -- such as meat, milk, and eggs -- larger imports either of meat or of animal feed will usually result. In Latin America, however -- and especially in Argentina and Brazil -- development is just as often accompanied by an expanding production of meat and animal feed. Instead of importing more as they develop, countries like Argentina and Brazil will probably continue to export more agricultural products, at times in competition with U.S. farm exports.

Outside of the U.S., nobody can produce soybeans for export in such volume at such low cost as Argentina and Brazil. These two countries have gone from negligable production and exports of soybeans in the 1960's, to 15 percent of world exports ten years ago, up to 26 percent of world exports last year. Last year these two countries alone also supplied 56 percent of world soybean meal exports, and 78 percent of world soybean oil exports. It is true that Brazil remains a significant importer of wheat and coarse grains, but lately a larger share of these imports have come not from the U.S. but from Brazil's own neighbor, Argentina, under the terms of a new grain trade agreement between these two Latin farm export giants.

Limited Demand Side Potential

Latin America is also different from much of the rest of the developing world on the "demand side." In most Latin American societies, in contrast to today's rapidly growing Asian societies, such things as land, education, political power, and social status tend to be narrowly held. As a consequence, income gains from economic "growth" tend to be narrowly held as well. As a result, the broad-based dietary enrichment and the demand for more imported agricultural products that ought to accompany development tends to be muted, or missing. Rapid economic growth in South Korea and Taiwan does produce broadly based dietary enrichment, and hence larger food imports. Rapid economic growth in Latin America is more likely to produce larger imports of various non-essential and mostly non-food consumer items, for the relatively well to do.

Even when broadly based dietary enrichment does take place in Latin America, agricultural import demands are nonetheless likely to be muted, if only because that region has such abundant grazing lands. Rapidly developing nations in Asia and the Near East usually can feed livestock only by expanding animal feed imports. Latin America can more easily expand herds with its own home grown or naturally available livestock feeds.

On both the supply side and the demand side, then -- and without even mentioning the debt crisis -- we can find reasons to be cautious about Latin America's future potential as a rapid growth market for U.S. farm exports.

But, say the optimists, wasn't Latin America, just a decade ago, an extremely rapid growth market for the U.S., and didn't it stop being a rapid growth market only after 1981, when the impact of the debt crisis was first being felt? This is what the trade figures seem to show. The nominal dollar value of U.S. farm sales to Latin America did increase roughly fourfold between 1973 and 1981, from a low level of just $1.7 billion all the way up to $6.4 billion. Then when the debt crisis "struck" in 1982, U.S. sales fell sharply, all the way back down to just $3.8 billion by 1987.

Limited Potential Even Without a Debt Crisis

For several reasons, however, I believe such figures tend to give an exaggerated impression of the market growth that might take place in Latin America if the current debt crisis were somehow to be miraculously resolved.

First, almost half of the U.S. sales growth that took place in Latin America between 1973 and 1982 took place in just one country -- Mexico. And much of this strong growth in Mexican agricultural imports was purely a temporary result of much higher Mexican foreign exchange earnings, from the export of temporarily high priced oil. Mexico is unlikely, any time soon, to enjoy a replay of this oil price related export earnings windfall. And in any case, I'm not sure that the U.S. economy -- or even U.S. farmers -- would want the suddenly higher energy prices that would be necessary to recreate such a windfall.

Second, much of the growth that took place in U.S. agricultural sales to the rest of Latin America took place in just two years -- 1980 and 1981. This market growth was attributable to another purely temporary event -- and also one which I suspect most of us would not want to repeat -- namely, the 1980-81 U.S. embargo on direct grain sales to the Soviet Union. Recall that when the U.S. temporarily stopped selling to the Soviet Union, because of their Afghanistan invasion, a number of other non-U.S. exporters -- including Argentina -- couldn't resist the temptation to sell more of their own grain to the Soviets, for premium prices. In order to do so they had to stop selling grain to some of their traditional customers in Latin America, especially in the Andean region. These abandoned Latin customers, in 1980 and 1981, quite naturally turned to the U.S., which had plenty of embargoed grain to sell.

Third, when the debt crisis did begin to constrain Latin imports, after 1982, it is of interest that agricultural imports -- at least from the U.S. -- were not at first so seriously affected. Between 1981 and 1984, the dollar value of U.S. agricultural sales to Latin America fell by only 17 percent, this at a time when total Latin imports were falling twice as fast. Latin imports of agricultural products were relatively immune from debt crisis constraints, fist because the U.S. was providing generous financing for its agricultural trade with Latin America during these early debt crisis years (nearly 50 percent of all U.S. farm sales to "problem borrowing countries" were shipped under Federal export programs in 1983), and second because Latin America's agricultural imports were only a small share of total imports (only about 11 percent in 1982), and hence relatively easy to sustain while other imports were being cut back.

Debt service burdens, therefore, are not always the dominant variable in the agricultural import equation. One little-noted USDA analysis, done in 1985, indicates that world market price constraints, and indigenous Latin farm production constraints, taken together, are more than twice as important as debt service constraints in determining variations in U.S. agricultural sales to Latin America.[2]

Finally, the trade decline that did occur after 1981 isn't necessarily a sign of vast market potential in a "debt free" Latin America, because the debt crisis didn't suddenly begin in 1981. it isn't just the decline in U.S. sales after 1981 that should be attributed to that crisis; it is also a part of the rise in sales prior to 1981. This rise was in part a result of the unsustainable foreign borrowing by Latin governments in the late 1970's that created the crisis in the first place.

This is a point we often miss. The only way for U.S. farm exporters to get back on the steep trajectory of rapidly growing exports to Latin America, the one they were briefly on before 1981, would be to return to a pattern of unsustainable Latin borrowing. This would revive U.S. farm sales to Latin America, for a while, but it would also create another debt crisis.

A Realistic Estimate of Latin Market Potential

So what is my estimate of the potential gain that might come to U.S. farm exporters from a resolution to the current Latin debt crisis? This must be an inexact science, but if we go back to the period of the early 1970's -- say, 1973 -- before the oil

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2. "Latin America: Outlook and Situation Report," USDA, ERS, RS-85-9, July 1985, p. 34.

boom, and before Latin governments began the pattern of unsustainable borrowing that led to the current debt crisis, we will find that total Latin farm purchases from the U.S. were then roughly 9 percent of all U.S. farm exports world wide. In 1981, mostly for the temporary and nonsustainable reasons that I have considered here, Latin purchases did rise briefly to equal 15 percent of the U.S. world export total. If we use the pre-debt crisis 1973 standard of 9 percent, rather than the inflated 1981 standard of 15 percent, we whould have expected U.S. farm sales in Latin America in calendar year 1987, for example, to equal 9 percent of that year's $31.3 billion total, or $2.7 billion. In fact, the total in 1987 was $3.7 billion! So Latin America, even at the depths of its debt crisis import collapse in 1987, was actually taking a larger share of U.S. farm sales world wide than it had been taking fifteen years earlier, before the borrowing patterns which led to the debt crisis began to accellerate.

<u>Conclusion</u>

What do I conclude from this brief analysis? I do not wish to imply that the debt crisis in Latin America is unimportant to U.S. agriculture. There is no doubt that, in the absence of this debt crisis, U.S. farm sales to Latin America would be larger than they are today. But, those of us who want to ease this crisis should not rest too much of our case on the problematic farm trade connection. There are plenty of other reasons, mostly linked to the future welfare and political stability of Latin America itself, why we should seek to relieve today's crushing burden of unservicable foreign debts.

Representative HAMILTON. Thank you, Mr. Paarlberg.
Mr. Rossmiller, please proceed.

STATEMENT OF GEORGE E. ROSSMILLER, DIRECTOR, NATIONAL CENTER FOR FOOD AND AGRICULTURAL POLICY, RESOURCES FOR THE FUTURE

Mr. ROSSMILLER. Thank you, Mr. Chairman.

I appreciate the opportunity to participate in this discussion and hope I can be useful to you in your deliberations on this important topic. I will summarize briefly the prepared statement that has been submitted for the record.

It is a given that a healthy Latin America, both economically and politically, is in the best interest of the United States. The economic and political situation of the indebted Latin countries is deteriorating seriously, rather than improving. The consequences to the United States are potentially very serious. A major factor is the external debt which must be reduced and removed before the situation has any hope of improvement. The United States, in its own self-interest, must help in this regard.

Many of the same macroeconomic factors and policies throughout the 1970's and 1980's were responsible for the Latin American debt crisis and the financial crisis in U.S. agriculture. The loose monetary policies of the industrial countries after the first oil shock of 1973 helped create the conditions within which the Latin countries and U.S. agriculture took on enormous quantities of debt.

The tight monetary policies followed by the industrial countries after the second oil price shock in 1979 created the conditions within which that debt in both cases became an unbearable burden.

U.S. agriculture policies in the 1980's were not helpful. The high scheduled loan rates in the 1981 agricultural legislation made U.S. agriculture uncompetitive in international markets, built large government stocks, and provided the incentive for export market competitors to increase production.

The 1983 Payment in Kind—PIK—Program caused U.S. agriculture to idle more land than all of Western Europe planted. The 1985 farm legislation brought us the Export Enhancement Program, originally designed to combat European Community subsidies. The Export Enhancement Program has lowered world prices, reducing foreign exchange earnings of indebted Latin American exporters of temperature zone crops, without leading to cost-effective improvement in U.S. exports.

The inflexibility of commodity programs prevented U.S. farmers from responding to a strong soybean market, thus handing Brazil and Argentina additional market penetration.

The debt crisis in U.S. agriculture has been resolved at substantial cost to producers, financial institutions, and the U.S. Treasury. Land values have fallen by one-third to one-half. U.S. agriculture is once again in a strong international competitive position.

In contrast, the Latin American debt crisis has not turned the corner, even with the debilitating austerity programs imposed by the IMF and the World Bank. In fact, it is worsening. It will not improve without debt relief. My conclusions are as follows:

First, U.S. farm programs should be designed in such a way that the value of farm support is not capitalized into land values. This will help in maintaining U.S. agricultural competitiveness in international markets.

Second, the Export Enhancement Program should be ended. It is not particularly helpful to U.S. exports, and hurts other exporters including those in Latin America.

Third, commodity programs should be more flexible to allow farmers to respond to changing market conditions rather than only to the programs.

And, fourth, the United States must help the indebted Latin American countries deal realistically with their debt problems in our own self-interest. This means some form of debt relief, assistance in adjustment to economic growth and political stability, and design of U.S. agricultural policy that has fewer adverse impacts on the international market, as we are attempting to accomplish with the international agricultural community in the GATT.

Mr. Chairman, I have attached to my prepared statement two communiques from the International Policy Council on Agriculture and Trade. This is a group of 28 agricultural leaders from 17 countries around the world, including 1 from Brazil and 1 from Argentina. The statements from that group are focused on the GATT and are an attempt to help countries move that process forward.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Rossmiller, together with attachments, follows:]

PREPARED STATEMENT OF GEORGE E. ROSSMILLER*

Latin American Debt and U.S. Agriculture

Understanding the relationships between the fortunes of the U.S. agricultural sector and the Latin American indebted countries requires a bit of history. We now have more than 15 years of experience since the first oil price shock in 1973 in dealing with significant and enduring shocks to the international economy. We have learned much about how these shocks are transmitted into national economies, and the need for subsequent actions that lead to growth and development rather than stagnation and decline. Certainly, we should be able to apply some of the lessons learned to the LDC debt, international development, and U.S. agricultural policy issues that we currently face.

After the first oil price shock in 1973, the industrial countries followed an expansionist monetary policy that resulted in relatively strong economic growth worldwide. Massive increases occurred in world liquidity, as commercial banks in the the United States and Europe recycled increasing quantities of petrodollars. Lending to the Less Developed Countries

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Resources for the Future
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increased at a 20 percent annual rate through most of the decade, at low and often negative real interest rates. This caused rapid accumulation of external debt by the borrowing less developed countries. The low value of the U.S. dollar in foreign exchange markets, along with large commodity stocks and idle land that could be drawn quickly into production, allowed U.S. agriculture to expand its international market share in an increasing market.

By the late 1970s, many U.S. agricultural producers and rural financial institutions were convinced that the export boom would continue indefinitely. This conviction drove many producers to expand, and in doing so, become heavily indebted to financial institutions that were only too willing to make loans in support of that expansion. The price of agricultural land soared as optimistic expectations were capitalized into land values.

Then came the second oil price shock in 1979. This time, the industrial countries lead by the United States reacted by severely tightening monetary policy, concerned more about controlling inflation than about maintaining economic expansion. By 1982 the bubble had burst - both for the LDC indebted countries, and the U.S. agriculture sector. And, for many of the same reasons.

The tight monetary policy of the industrialized countries plunged the world into economic recession, and escalated real interest rates from low or negative to positive and high. Both indebted LDCs and indebted United States farmers were suddenly in serious trouble.

U.S. farmers were facing weakened export demand, particularly from the Less Developed Countries, and falling prices. The loss of export markets was exacerbated by the rigid price supports in the 1981 farm legislation to the extent that U.S. producers were losing market share in a declining international market and the government was rapidly building stocks. As a result of the Payment In Kind program initiated in 1983, the United States idled more acreage than all of western Europe planted. Farm financial stress continued to mount.

The 1985 farm bill had three prime objectives. To restore competitiveness of U.S. agriculture in international markets, to maintain farm incomes in the face of the financial stress, and to do so without breaking the budget. The first two objectives were accomplished by lowering loan rates and freezing target prices during the first two years of the bill with slight declines in the last three years. The budget objective was less well met with an expenditure on farm programs of $26 billion in 1986, although farm program costs have reduced substantially since that peak. By 1987 agricultural exports had begun to turn the corner and again rise. Farm financial stress was easing and land prices were stabilizing. U.S. agriculture appears to have weathered the storm, but at a substantial cost.

A major consequence of the adjustment of U.S. agriculture during this period was a reduction in land asset values of between one-third and one-half. Loss of loan collateral and high interest rates caused a significant number of farm bankruptcies as well as loan restructuring and write offs of loans by lending institutions. Congress considered and finally passed bailout legislation for the farm credit system. And government deficit spending that expanded demand and employment helped ease some of the adjustment. The adjustments that were made were very painful indeed to the individuals involved, but the adjustments did occur and the sector has come out in a stronger competitive position.

In contrast, the indebted Less Developed Countries were not fairing so well. The stringent austerity programs insisted upon by the IMF and the World Bank promoted recessionary economies. That coupled with weak world markets for Latin exports made the heavy debt burden worse. Economic growth has been curtailed with increased social unrest and political instability as a natural consequence. And this unreasonable debt burden will continue to disrupt the Latin American economies until further steps are taken to reduce and, within a realistic time frame, eliminate it entirely. Quite aside from the purely economic and trade linkages between the United States and Latin America, the growing social unrest and political instability in the region, is a matter of grave concern.

While U.S. agriculture has become increasingly concerned in recent years about agricultural export competition from some of the Latin American countries, it is important to remember that Latin American is the third largest regional market for U.S. farm exports behind only Asia and Western Europe. U.S. agricultural exports peaked to Latin America in 1981 at $6.4 billion dropping to $3.6 billion in 1986 before beginning to recover. Moreover, of the four most heavily indebted Latin American countries, Mexico has been the largest Latin American export market for U.S. agriculture in every year since 1970, with Brazil and Venezuela ranking second or third. These three countries combined, accounted for about 54 percent of U.S. farm exports to Latin America in 1987. Argentina, of course, has been and will continue to be an important competitor in international markets in wheat, corn and soybeans, as will Brazil in soybeans.

The threat of Latin American competition with U.S. agriculture when taken as a whole, is mitigated on two counts. First, U.S. agriculture specializes in temperate zone commodities, while the main Latin American production zone specializes in tropical agricultural commodities. Argentina and Brazil are agricultural competitors of the United States in export markets. They have the resource base to continue that competition, even increase it, quite apart from the debt issue. Their competitiveness should not be taken as an excuse for the United States to withdraw from assisting them in reducing the debt and in furthering their economic development. On balance, we potentially have much to gain, and actually very little to lose, by helping the Latin nations to overcome their unreasonable debt burdens.

Second, and more importantly, broadly based economic development and rising per capita incomes will lead to greater demand for U.S. feedgrains as consumers demand increased animal proteins in their diets, particularly from pork and poultry. But, broadly based economic growth will be limited as long as external debt burdens overhang these Latin American economies. It is in the interest of the United States economically, as well as for geopolitical stability in the region, that the Latin American debt issue be resolved with U.S. help. And, taken as a whole, even U.S. agriculture will benefit.

Interestingly enough, even the American Soybean Association agrees. In a February 1987 publication titled "The Latin American Debt Situation And U.S. Agriculture," they state:

"Between 1981 and 1985 the value of U.S. agricultural exports to Latin America fell 32 percent while Latin American exports to the United States have risen 16.7 percent. ...Debtor nations have acutely felt the effects of domestic belt tightening. Austerity programs have forced recession on many countries. Rising unemployment and out of control inflation, falling GDP and weakening terms of trade have become hallmarks of debtor nation economies. Political stability in many newly elected democracies such as Brazil and Argentina is threatened. ...From the standpoint of U.S. agriculture, the best solution to the international debt crisis is one which conditions a systematic writedown of Latin American debt upon the designated country's adoption of specific policies. Such policies include eliminating import barriers and export subsidies, and diverting a greater share of domestic production of food and fiber for internal consumption."

Obviously, the latter can only take place under conditions of rising per capita real incomes. As for eliminating export subsidies, Argentina and Brazil have none to eliminate. In the past they have imposed export taxes on agricultural exports. Further in the case of soybeans, the United States handed Brazil and Argentina additional export markets when U.S. producers had to plant corn base acres to corn to preserve their base, rather than planting soybeans in response to the market.

Agricultural exporters, like Argentina and Brazil, have been hurt badly by the subsidy war between the European Community and the United States through our export enhancement program and the EC's export restitution subsidies. Early estimates by the Economic Research Service, U.S.DA, and others indicate that the main affect of the export enhancement programs has been to reduce international market prices and to reroute agricultural trade flows. Export additionality resulting from the export enhancement program is estimated to be certainly not greater than about 30 percent. This works out to cost the U.S. government on the order of $6.00 per bushel of increased wheat exports - hardly cost effective. One should in any case question the wisdom of subsidizing to increase market share in volume terms without regard to what happens to export revenues.

This is only one of the issues of importance in the agricultural negotiations presently underway in the GATT. A recent study by the International Agricultural Trade Research Consortium estimates that fully two-thirds of the cost of U.S. farm support in 1986 went to offsetting the effects of farm support by other countries. In the EC the proportion was one-third and in Canada well over half. This alone is a compelling case for trade liberalization. Latin American countries clearly see trade liberalization as in their self-interest. At the Montreal mid-term review it was a group of Latin countries that led the charge to not ratify agreements reached in other sectors since no agreement was reached in agriculture. If they choose, they can do so again at the end of the GATT Round if agreement on an agricultural package is not forthcoming.

From the above discussion, we can draw four major conclusions. First, land prices in the United States are an important factor in the competitiveness of U.S. agriculture in international markets. The events of the 1980s having thwarted the optimistic expectations of the late 1970s, significantly reduced land values and resulted in greater U.S. international competitiveness. Future farm legislation might well be designed to assure that program benefits do not become capitalized into land values and thus reduce U.S. international competitiveness.

Second, the export enhancement program while perhaps a negotiating device in the GATT negotiations, although many would question the validity of this assertion, is not all that helpful to expanding U.S. agricultural exports, and is certainly harmful to the Latin American agricultural exporters. Future farm legislation should eliminate this export subsidy program.

Third, the inflexibility of the U.S. commodity programs can reduce U.S. competitiveness. The relevant example here is the case of the corn program preventing producers from responding to a strong soybean market, thus providing the opportunity for Brazil and Argentina to increase soybean exports. Future farm legislation should provide for flexibility in this regard.

Fourth, Latin America is an extremely important market for U.S. agricultural exports. Before the economic recession and mounting debt problems in the region, it was an even better market. It can, once again, become a strong and growing market for U.S. agricultural exports only when economic growth and rising per capita real incomes again become a reality. Before that can happen, the debt problems must be alleviated. It is in the best interest of the United States in general, and U.S. agriculture in particular, to help in this regard.

One other observation is important, although less easily dealt with, in the context of this discussion. That is, U.S. macroeconomic policy, and that of the other industrialized countries, has probably had more influence on Latin American indebted countries and U.S. agriculture than either U.S. farm policies, or policies designed to alleviate directly the debt problems.

SUGGESTIONS TO THE NEGOTIATORS FOR THE MIDTERM REVIEW AND THE URUGUAY ROUND ON AGRICULTURE

A Communique of the International Policy Council on Agriculture and Trade

MONTEBELLO, CANADA - SEPTEMBER 24, 1988

1. The Uruguay Round of GATT negotiations offers a unique opportunity to correct the disarray in world agricultural trade. However, despite the initial promise afforded by the Punta del Este declaration and the communiqué of the Organization for Economic Cooperation and Development, as well as several summit meetings, the negotiations are bogged down. The Midterm Review in Montreal in December 1988 is the first chance for concrete action in the Uruguay Round.

2. Recent market and policy developments might appear to have eased the pressure for reform, due to stronger world prices for several commodities and reduced budget outlays, but the structural causes of market imbalance remain and must be addressed.

3. All countries, but in particular the United States and the nations in the European Community (EC), have a major responsibility to resolve their differences in a multilateral framework, in order to avoid causing further damage to other trading nations. The International Policy Council on Agriculture and Trade (IPC) cautions governments against delay and urges the GATT to use the Midterm Review as a chance to move forward with speed.

4. Recent market and policy developments have achieved some of the short-term improvement in market conditions sought by some negotiators. At the same time, these developments have lowered the political and economic costs of making further progress.

5. The IPC calls on governments to use the Midterm Review to show that they are serious about their commitments. This should start with an immediate freeze of trade-affecting support at current levels and an agreement on an initial reduction of such support to be achieved within the next two years.

6. The IPC believes that attention can now focus on negotiations of longer-term policy reform. The direction of policy reform should involve the linking of domestic and world markets to facilitate the transmission of market signals, thus bringing every country's producers and consumers to participate in the adjustment to international market conditions. The direction of policy reform should equally involve a graduated replacement of market interventions by other forms of social, structural, environmental, or regional support that are unrelated to production.

7. Governments should agree at the Midterm Review on a program of progressive reductions in all forms of support affecting agricultural trade, to be applied across the board and by all participating countries for all commodities. The IPC considers that the use of an aggregate measure of support will facilitate the negotiation of commitments and their subsequent monitoring.

8. The IPC proposes that during the remainder of the Uruguay Round governments agree to at least a 50 percent across-the-board reduction in trade-distorting support over a fixed period. Special and differential terms may be provided for developing countries.

9. Moreover, the IPC believes that the mid-term review should agree to strengthen, simplify, and make transparent GATT rules and disciplines, particularly with regard to access and to trade-distorting subsidies and taxes, so that fundamental GATT principles apply more fully to agriculture.

10. During the period of reform, access to markets and supplies must be increased. This means a progressive reduction of subsidies and of import and export restrictions and a prohibition of all embargoes.

11. It is also essential to prevent the use of health and sanitary regulations as nontariff barriers. Governments should agree to harmonize these regulations, to tighten the relevant GATT procedures, and to strengthen the GATT linkages to international standards organizations.

12. The IPC believes that it is necessary to strengthen significantly the surveillance and dispute settlement process in the GATT.

13. The IPC believes that any framework agreement must include the establishment of a mechanism to monitor commitments on domestic policies and to compare the policy developments to the stated commitments.

14. The active participation by developing countries in GATT negotiations should be vigorously encouraged so that their special interests are taken into consideration.

15. The developing countries have been adversely affected by the present disarray in world agricultural trade (including tropical products). Their access to developed countries' markets has been curtailed, and the prices of their exports in world markets have been undermined by developed countries harmful subsidization. A more disciplined trading system would therefore promote their growth and, for those countries that are now heavily indebted, will go some way toward alleviating their problems.

16. If trade liberalization raises world food prices or reduces food aid and thus adversely affects food-importing developing countries, transitional measures should be adopted. The modality by which these measures are to be implemented should be the subject of negotiations in connection with the present round. This would be in addition to development aid--technical, financial and food aid--aimed at facilitating more rapid economic growth.

17. The IPC will continue to alert governments and the public about the issues at stake and about the ways of addressing them.

APPRAISAL OF THE APRIL 1989 MIDTERM REVIEW AGREEMENT IN THE URUGUAY ROUND ON AGRICULTURE

Communique of the International Policy Council on Agriculture and Trade

COBHAM, SURREY, UNITED KINGDOM - APRIL 29, 1989

1. Members of the International Policy Council (IPC) welcome the framework agreement on agriculture adopted in Geneva on 8 April. The agreement represents an important commitment by all the contracting parties to make agriculture more responsive to international market signals; to reduce the support and protection for agriculture which have seriously distorted the levels and patterns of production and trade: and to bring agriculture more effectively under the discipline of GATT rules.

2. Changes in agricultural policy in these directions have already begun on national initiative. The Council welcomes these in many countries including, notably the European Community, the United States and Japan. We believes that the developments are significant and should be recognized as being of multilateral value. Much more needs to be done.

3. The framework agreement of 8 April contains important undertakings not to increase current levels of support or protection. The Council Members stress how essential it is that these undertakings are implemented in both the letter and the spirit of the agreement. This is necessary if there is to be mutual confidence among governments that all are serious about the task of reform and the intentions to pursue it on a multilateral basis.

4. The current improvements in world markets and the relief they provide to agricultural budgetary pressures should not be allowed to divert attention from the need for the policy changes now under discussion in the GATT. They are justified whatever the market situation. The Council strongly urges all Governments to enter into the negotiations for the long term with a will to succeed in bringing about "substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets."

"Sustained progressive reduction" needs to be made specific. The timetable for negotiations laid down in the 8 April text should be respected. The negotiations are bound to be difficult and complicated: nothing is to be gained by delay. The Council greatly welcomes the global nature of the agreement, drawing into the GATT for the first time domestic as well as external trade measures affecting agriculture. We recognize that this may be achieved through negotiation on the policies themselves and/or through the use of an aggregate measure of support. Council members stress the importance of negotiating reductions in support and protection on an across the board basis. To be fully effective and equitable the reductions in support and protection must embrace all commodity sectors and be reinforced by effective rules.

5. Council Members welcome the inclusion in the framework agreement of 8 April of the recognition that the particular needs and conditions of all developing countries should be fully taken into account at all stages of the negotiation.

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6. A successful agricultural negotiation based on the 8 April text would not only reduce budgetary and consumer costs of farm support and ease tension in world trade, but also lead to a stronger world agriculture. The potential economic benefits are substantial and they can be achieved without undue hardship to the agricultural sector by the use of appropriate policy adjustments. The adjustments in domestic and trade policies required are likely to complement those needed for environmental reasons.

7. Finally, the agricultural negotiation forms an integral part of the Uruguay Round as a whole which includes other important sectors like services, intellectual property and investment. Bringing agriculture effectively within the GATT would itself be a landmark. But, as was made clear in Montreal, failure in agriculture would put the whole Uruguay Round at risk.

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The International Policy Council on Agriculture and Trade, a group of twenty-eight policy experts from seventeen countries, was established to develop consensus on realistic and feasible policy alternatives that could alleviate the problems facing global agriculture. The Council is not sanctioned by any government. Its members include individuals from government, business, farm groups, banking, and academia in developed and developing nations. Council members actively convey their recommendations to governments both publicly and privately.

Members:

Lord Plumb of Coleshill (Chairman) -- President of the European Parliament. Former President, International Federation of Agricultural Producers (United Kingdom)

Albert Simantov (Vice Chairman) -- President of the Governing Board, International Center for Advanced Mediterranean Agronomic Studies. Former Director for Food, Agriculture, and Fisheries with Organization for Economic Cooperation and Development (Greece)

Michael Andreas -- Group Vice President, Archer Daniels Midland Company (United States)

Sir Michael Franklin -- Former Permanent Secretary, Department of Agriculture, Forestry, and Fisheries; Deputy Director General, Directorate General for Agriculture, European Community (United Kingdom)

Dale Hathaway -- Vice President, Consultants International. Former Undersecretary for International Affairs and Commodity Programs, U.S. Department of Agriculture, and Director, International Food Policy Research Institute (United States)

Heikki Haavisto -- President, Farmers Union, Finland and Vice President, International Federation of Agricultural Producers (Finland)

Lorne Hehn -- President, United Grain Growers, Ltd. and United Livestock Feeds, Ltd. Director, Prince Rupert, Ltd. and Ridley Grains, Ltd. (Canada)

Dean Kleckner -- President, American Farm Bureau Federation (United States)

Eoshiro Matsuyama -- Managing Director, Foods, Mitsubishi Corporation (Japan)

Flavio Teles de Menezes -- President, Brazilian Rural Society (Brazil)

William Miner -- Senior Research Associate, Institute for Research on Public Policy. Formerly Special Advisor to Agriculture Canada during GATT negotiations (Canada)

Robbie Mupawose -- Director, Zimbabwe Leaf Tobacco Company; former Minister of Agriculture (Zimbabwe)

Michael Nugent -- Chief Executive, Elders Agribusiness Group, Elders IXL Ltd. (Australia)

Janos Nyerges -- Special Advisor, Hungarian Chamber of Commerce; former Special Representative of the Hungarian Government to the United Nations and GATT (Hungary)

Hans-Jurgen Rohr -- Managing Director, DG Agropartners. Former Secretary General for Agriculture, Federal Republic of Germany (West Germany)

George E. Rossmiller (ex-officio) -- Executive Director, International Policy Council on Agriculture and Trade (United States)

S. R. Sen -- Director, National Bank for Agriculture and Rural Development, India. Former Executive Director, World Bank (India)

Michael Shanahan -- Deputy Chairman, Australian Wheat Board. Former Vice President, Australian National Farmers Federation (Australia)

Ammar Siamwalla -- Program Director, Agriculture and Rural Development, Thailand Development Research Institute (Thailand)

David Swanson -- President and Chief Executive Officer, Central Soya. Former Senior Vice President, Continental Grain Company (United States)

Stefan Tangermann -- Vice President, University of Göttingen; Professor, Institute for Agroeconomy, University of Göttingen (West Germany)

Robert Thompson -- Dean of Agriculture, Purdue University. Former Assistant Secretary for Economics, U.S. Department of Agriculture (United States)

Thomas Urban -- President, Chief Executive Officer, and Chairman, Pioneer Hi-Bred International, Inc. Former Mayor Des Moines, Iowa (United States)

Claude Villain -- Inspector General of Finance (France). Former Director General for Agriculture, European Community.

Layashi Yaker -- Ambassador at Large and former Minister of Commerce (Algeria)

Yutaka Yoshioka -- Chairman, Japan International Agricultural Council. Former Director, Economic Bureau, Ministry of Agriculture, Forestry, and Fisheries (Japan)

Aart de Zeeuw -- Chairman, Agricultural Negotiations Committee, GATT (Netherlands)

Jorge Zorreguieta -- President, Argentine Sugar Producers Council. Former Minister of Agriculture, Argentina (Argentina)

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April, 1989

Representative HAMILTON. Thank you very much, Mr. Rossmiller. Those attached statements will be made a part of the record.

Mr. Schuh, please proceed.

STATEMENT OF G. EDWARD SCHUH, DEAN, HUBERT H. HUMPHREY INSTITUTE OF PUBLIC AFFAIRS, UNIVERSITY OF MINNESOTA

Mr. SCHUH. Thank you, Mr. Chairman. It is a pleasure to be here this afternoon.

I want to address five points briefly that come out of my prepared statement. One of these points has to do with the lack of reform in the Latin American countries and the extent to which that contributes to their continuing problems. I discuss this quite a bit in my prepared statement. These countries almost uniformly discriminate very seriously against their agriculture. They do this by a wide variety of policies: highly overvalued currencies, large explicit export taxes, complicated licensing procedures for exports, embargoes on exports, everything designed to channel their agricultural output to the domestic economy.

That has a very serious impact on their ability to service their debt problem and to deal with it. And one of the points that I make is that until they address those problems, they simply will not be credible critics of U.S. policy.

The related point that I discuss in the prepared statement is the difficulty in bringing about this policy reform, and I make some comments about how the United States could help bring about these policy reforms.

The second point is the need for reform in U.S. agricultural policy. In fact, the way I describe this in my prepared statement is to say that there is a lot of sinning going on on both sides, both on the Latin American side and on the U.S. side. The particular way that we have chosen in this country to provide income transfers to agriculture leads to the accumulation of large stocks and the idling of a lot of land. The consequence is that we frequently get into dumping abroad by the use of export subsidies, and those export subsidies do in fact have rather deleterious consequences on not only Latin American countries, but others as well.

The suggestion I make is that we decouple the income transfer program from the price level and let the prices do their job of allocating resources. There are a number of variants of that proposal around. This is not to quarrel with the need for income transfers to agriculture. It is to argue that we should be more certain that the income transfers get to the people who need the income and not to well-to-do people in the sector.

I also make the point that, as a nation, we can no longer afford to idle some of our most important resources nor to provide large income transfers to well-to-do people.

Third, I make the point that reestablishing growth in Latin America is the key issue, and that this has to come from internal reform. I think the United States can help bring about that reform, and I emphasize the fact that markets are associated with economic growth, not with hungry bellies. That was the lesson of the

1970's. And I think in this respect I disagree with my colleague Robert Paarlberg. I think there is a lot of market potential in Latin America if we can reestablish growth. The reason for that is that it's very difficult to get agricultural output growing at the rate that will be necessary to meet the increased demand if even modest rates of economic growth occur in that region.

Fourth, I make the point that we shouldn't lose sight of the potential for international specialization or the emergence of new markets. I say that in the context that people see the Brazil experience with soybeans, see them taking our markets away, and lose sight of the fact that the United States has a comparative advantage in feed grains, and has an enormous market potential in that very country.

There are some data compiled by the USDA that show that when Brazil was making so much progress with their soybeans in international markets, their demand for agricultural output from the United States grew by 15 percent a year in physical terms and by 25 percent a year in value terms, and that was over something like a 12-year period.

The final point I make in my prepared statement, and what I would emphasize here, is that a lot of this question about how competitive we are, how competitive they are, has a lot to do with the relative value of national currencies. I am struck by the fact that there is always this desire to get back to the 1970's in terms of U.S. agricultural trade performance. I think there is less recognition that we did that well only because we had a very weak dollar, and that there were some high costs of having a very weak dollar. Similarly, a lot of our difficulties in the first half of the 1980's was associated with a very strong dollar that was associated with our monetary and fiscal policy.

That gives a flavor of some of the things I have in my prepared statement. Thank you, Mr. Chairman.

[The prepared statement of Mr. Schuh follows:]

PREPARED STATEMENT OF G. EDWARD SCHUH

U.S. Domestic Farm Policy and the
Latin American Debt Problem

Mr. Chairman, members of the Committee, participants in the panel, and observers.

I appreciate the opportunity to participate in this important hearing on the potential incompatibility between U.S. agricultural policy and the eventual resolution of the Latin American debt problem. This is a case in which "sinning" takes place on both sides of the relationship. The challenge for this nation is to sort out where our longer term interests lie. Reforms are needed on both sides if we are to make more efficient use of the world's agricultural resources and thus improve the standard of living of its citizens. Reforms are also needed if Latin American debts are to be serviced and eventually paid off, and if U.S. farmers expect to have growing markets for their output in the future.

The remainder of my testimony is divided into four parts. First, I will review the source of Latin America's debt problem. Second, I will discuss why it has been so difficult to resolve.

Third, I will review U.S. agricultural policy and explain how it contributes to the debt problem. Fourth, I will suggest some reforms which can help both the United States and the Latin American debtor countries shift to more efficient growth paths.

The Source of the Latin American Debt Problem[1]

The Latin American debt problem is rooted in the flood of petrodollars unleashed by the large increase in petroleum prices in 1973, and again in 1979. It is also rooted in the policy mistakes associated with those episodes.

Petroleum is priced and transacted for the most part in U.S. dollars. The increases in petroleum prices thus gave rise to a flood of so-called petrodollars. There was much concern at that time that unless these petrodollars were recycled there would be a collapse of the global economy. Consequently, many economists--and many policy-makers as well--enjoined the international commercial banks to recycle the petrodollars.

On the other side of the exchange, many developing countries--especially the petroleum importers--faced serious problems. The rise in petroleum prices worsened their external terms of trade in a very significant way. The classical treatment for such a problem is to devalue one's currency. This spreads the needed adjustment throughout the economy, channels resources to the export sector and raises the prices of imports,

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[1] This section and the one that follow is drawn from an earlier paper of mine, "Latin American Debt: Living on Borrowed Time."

and thus eventually restores balance to the external accounts.

The problem, however, is that most countries--and especially developing countries, don't like to undertake devaluations of their currencies. Governments often fall as a consequence of a devaluation, and political leaders are not prone to committing political suicide. Consequently, policy-makers in developing countries will do almost anything rather than to devalue their currencies.

This gave rise to a nice marriage. The petroleum-importing developing countries could solve their problems at least in the short-term by a capital inflow or borrowing. The owners of the petrodollars thus readily found places to put their funds, and in effect the petrodollars were recycled--to a fault. This money was loaned to the developing countries with very little serious appraisal or analysis of the ability of the developing countries to repay. Similarly, there was very little conditionality, or policy reform imposed as a basis for the loans. In fact, the borrowing was for all intents and purposes *in lieu* of the needed policy reform.

As time went on, these economies became more and more out of adjustment. This meant that the needed policy reforms became larger and larger, and more and more painful politically. It is that aversion to reform--made possible in part by the ability to borrow from the international capital market--that has made the problem difficult to resolve.

Why Progress Has Been so Slow in Dealing With the Debt Problem

There are a number of issues here. First, the developing countries, and especially Latin American countries, have been unwilling to undertake the policy reforms needed to put their economic houses in order. These reforms usually involve very large devaluations--devaluations larger than the apparent discrepancy between official rates and black market rates. Such large devaluations are painful both economically and politically, and few policy makers will willingly undertake them.

Another part of the needed reforms is a shift in policy orientation from the import-substituting industrialization drives that have dominated economic policy in the post-World War II period to more outward-looking, export promotion policies. This requires a complete change in how policy-makers in those countries think about their policies and what they are attempting to accomplish.

Second, industries that could compete internationally are generally atrophied and the support sectors for these industries are generally underdeveloped as well. The neglect of these sectors in the past is what has brought about this problem. The point is that it takes time to bring about these shifts in resource allocation and to develop both the potential export sectors and the sectors that support them. A critical issue here is the failure to develop modern technology for these sectors.

Third, policies of the developed countries have been predatory, and counter to exporting by these countries. Chief among such polices among the developed countries is the agricultural export subsidy war between the United States and the European Community. This "war" drove the prices of potential export crops for these countries to all-time low levels in 1986, 1987, and 1988. Although these export subsidies by the developed countries may bring considerable benefits to consumers in these countries, the producer sectors pay a high price. Moreover, this dumping forces substantial adjustments on to the developing countries.

Fourth, there has been a lack of capital flows to these countries--capital flows that are needed to revitalize the export sectors. This was to have been the key element in the so-called Baker Plan put forth by Secretary of the Treasury Baker. The problem is that most commercial banks view this as throwing good money after bad--especially in light of the failure of these countries to undertake the needed policy reforms.

Fifth, there has been a failure to implement complementary policies that would ease the political and economic pain of the policy reforms. Chief among these has been the failure to develop targeted feeding programs that would help offset the domestic consequences of the policy reform. The problem is that the realignment in the exchange rate causes the domestic price of food to rise. Most developing countries either export or import agricultural commodities, and many do both. The devaluation causes the domestic price of food to rise. This tends to be a particularly serious issue for politically volatile urban consumers, who often are in the streets whenever domestic food prices rise. After all, one of the important reasons for the overvalued currency in the first place is the desire to keep the price of food to these groups low.

A parallel, and somewhat more difficult problem, is that much of the labor force in these countries is employed by an overblown public sector or in nationalized industries. The rise in food costs lowers the real wage and creates its own political difficulties. One solution is to raise the nominal wage to offset this. But this has enormous budget implications, and can itself cause other reforms such as bringing inflation under control to fall by the way side.

Finally, the policies of institutions such as the World Bank and the bilateral donors have not always been as effective as they could be. The emphasis has been on adjustment lending, with a purported emphasis on conditionality or policy reform. However, especially in the case of the World Bank, this lending has not gone to the heart of the problem. Instead, it has for the most part been counter-productive.

<u>Domestic U.S. Agricultural Policies</u>

U.S. agriculture has for some years consistently produced more than markets have been able to absorb at prevailing price levels. This has led to the periodic accumulation of large stocks, and to a variety of programs that provide the means for disposing of the excess abroad, less politely known as dumping.

These programs range all the way from food aid programs to the current explicit export subsidy programs.

U.S. agriculture's chronic tendency to excess production is rooted in the means by which income transfers are provided to the farm sector. Rather than to provide means-tested income transfers, income goals are translated into price objectives and market prices are either fixed at those levels by protectionist measures or income transfers are based on the price objective.

Three different elements of current farm programs have significant negative impacts on the agriculture and general economies of Latin American countries. The first of these is the sugar program. This program sets sugar prices significantly above international prices by a system of fees and tariffs. Imports are further rationed by a system of import quotas.

This program has as much to do with protecting the corn sweetener industry as it does with protecting domestic sugar producers. As that protection has stimulated the corn sweetener industry, import quotas for sugar have been successively reduced. This loss of market has imposed large economic adjustments on some Latin American countries, such as the Dominican Republic. In fact, the Caribbean Initiative was necessary in large part because of the loss of markets countries in the region experienced due to the sugar program. These countries lost an important source of foreign exchange earnings.

The second element of the farm programs which affects Latin American countries is the deficiency payment scheme. From an efficiency standpoint, a deficiency payment scheme has much to recommend it since it does permit domestic consumers to benefit from the lower market prices the high target prices engender. Target prices set above market-clearing levels cause output to be greater than it would otherwise be.

But this program has international ramifications as well, although these are seldom recognized. In the case of wheat, for example, in which the United States is a large enough supplier to influence international prices and in which the target is set significantly above market-clearing levels, the deficiency payment scheme is an implicit export subsidy. Although there are no cash transfers to importers, the program causes U.S. and (in the case of wheat) world prices to be less than they would otherwise be. The United States is thus more competitive than it would be in the absence of the program, and other exporters and potential exporters lose markets and foreign exchange.

The third element of the farm program which effects Latin American countries is the program of explicit export subsidies established with the 1985 farm bill. This program was a response to the extensive use of export subsidies by the European Community. Unfortunately, it has led to a literal export subsidy war between the United States and the EEC, with effects on markets and market prices that are disproportionate to the amount of grain actually moved under the program.

The issue, of course, is the effect of these programs on Latin American debtor nations. The effect of the sugar program on exporter or potential exporter nations is clear. Markets and foreign exchange are lost, with serious consequences in terms of the ability to service foreign debt. Countries that import sugar may benefit from the decline in international prices that result from the reduction in U.S. markets, but that is not likely to be significant in Latin America.

It is not possible to generalize about the effect of export subsidies. It is quite common to argue that developing countries should benefit from export subsidies since such subsidies benefit consumers with lower prices and presumably reduce the cost of the import bill. That view is naive in a number of respects.

In the first place, exporters are obviously harmed both by the loss of markets and the decline in world price that results. In Latin America, Argentina is an exporter of both corn and wheat. It is also a major debtor nation. It suffers significant negative consequences from U.S. export subsidies, both implicit and explicit.

For importing nations, the story is different, but not nearly as simple as it might seem. It is widely recognized that consumers in importing countries can benefit from export subsidies by exporting nations. But the important caveat is that importing countries should accept imports on these terms only if exporters are willing to make a permanent commitment to continue the subsidy. The experience of the 1970s makes clear that this nation is not prepared to make such a permanent commitment to export subsidies.

Another important issue is the price responsiveness of import demand. If the quantity demanded increases proportionately more than the reduction in price made possible by the export subsidy, the nation's import bill will increase even though the per unit cost of the import declines. Consumers will obviously be better off. But the balance of payments implications for a nation with foreign debt to service could be quite serious. What appears to be an advantage is not an advantage at all.

Finally, there is the difficulties with the competing domestic sector and with substitute commodities. Most importers of agricultural commodities are only marginal importers. Hence, in most cases there is a domestic sector that competes with imports. Moreover, if there is a domestic sector which is a close substitute for the imported commodity, it too will be affected by the subsidized imports.

There are two issues here. First, agriculture is a major part of the economy in most developing countries. The effects of the export subsidies can be pervasive in those countries, with negative effects on general economic development. But it is economic development in those countries that offers the best potential for future U.S. markets. The use of export subsidies to gain a short-term advantage in these markets may well be short-sighted.

Second, the use of export subsidies by the United States may well impose serious adjustment problems in the developing countries. Labor will be pushed out of the sector into already crowded urban centers. Typically, this labor will be unemployed and a burden on already over-burdened welfare systems.

The truth of the matter is that unless the United States is willing to make a permanent commitment to the use of export subsidies, importing countries would be entirely justified in putting up protective tariffs to cancel out the effect of the export subsidies. Such tariffs are called counter-vailing duties, and they are permitted under the rules of the GATT.

In concluding this section it is useful to make some mention of PL 480, this nation's food aid program. There was a time, back in the second half of the 1950s and the decade of the 1960s, when this program for all practical purposes acted as an export subsidy program. Despite all the nice rhetoric about feeding the poor and Food for Peace, by most criteria it was simple dumping.

This program is no longer as guilty of that change as it was in the past, but it is still not completely free of criticism. With more serious attempts to provide this food as income transfers to the poor in the recipient countries, the so-called disincentive effects of the program could be almost completely eliminated.

Suggestions for Policy Reform

Most developing countries seriously discriminate against their agriculture by policy means. The urban bias to their agricultural policies are now well known. This bias includes over-valuation of their currencies, which is an export tax and an import subsidy. It also includes the widespread use of explicit export taxes, embargoes on exports, marketing boards which buy cheap from farmers and sell dear, and the use of complicated export licensing procedures. All of these measures are designed to channel domestic production to domestic markets, and to forego foreign markets.

Reform of these policies so as to allow their producers access to international markets at the price levels prevailing in those markets would significantly broaden the basis of economic development in those countries. It would also significantly increase their foreign exchange earnings by making their producers more competitive in international markets.

Until the governments of Latin America and other developing countries are willing to stop this discrimination against their producers, they simply are not credible in their complaints against the use of export subsidies by the United States. That does no justify the use of export subsidies by the United States. It does suggest the until developing countries get their own economic houses in order, they will not be legitimate protestors against U.S. policies.

The United States, for its part, also needs to get its economic house in order. The issue is not so much whether the government should provide income transfers to farmers or not. The issue is the <u>means</u> by which the income transfers should be provided.

The various proposals which have come forward to decouple the income transfers to farmers from the prices of the commodities are a step in the right direction. With such programs in place, domestic prices would move to levels consistent with efficiency prices, supply would be brought into balance with demand, and the need to carry costly stocks would no longer be present. Farmers would receive income payments only as they met some income standard, and the payment of large income transfers to farmers who are not poor would no longer be a drain on the U.S. budget.

The United States could do one additional thing to help bring about policy reform in the developing countries. One of the reasons these countries find it difficult to reduce or stop their discrimination against agriculture is that it almost inevitably involves an increase in food prices to urban consumers. These groups are highly concentrated and politically violative.

The solution to this problem is to develop targeted feeding programs that provide food to disadvantaged groups at less than market prices. This country has long done that here at home with its food stamp program. The United States could make a significant contribution to policy reform in these countries by helping them to design similar programs. The careful use of food aid could then be a useful complement in helping to get such programs started.

I would like to conclude this section by making two additional sets of comments. First, an important issue in whether the United States can compete abroad is the value of the dollar in foreign exchange markets. The experience of the last twenty years provides ample evidence on this. U.S. agriculture was very competitive in the 1970s, when the dollar was weak. It lost a great deal of its competitive edge in the first half of the 1980s when the dollar became very strong again. And it has required foreign markets in recent years as the dollar-until several months ago-has declined again.

Second, in considering our trade opportunities, we need to keep the principles of international specialization and comparative advantage in mind. It could well be that Brazil will continue to gain an ever larger share of the world soybean market. But the United States has a clear comparative advantage in the feed grains. We may well find our exports of corn to Brazil growing at a rapid rate at the very time our exports of soybeans decline. Corn and soybeans are substitute crops throughout most of the corn belt.

Concluding Comments

Future markets for U.S. agriculture will clearly be in the developing countries. Whether those markets come to fruition will depend a great deal on how successful those countries are in their economic development efforts. Markets are based on income, not hungry bellies. This nation has every reason to make a serious commitment to help those countries develop. This is not an issue of benevolence. It is an issue of enlightened self-interest.

Representative HAMILTON. Thank you very much, gentlemen, for your statements.

We welcome, of course, Congressman Jontz from the House Agriculture Committee, who is with us this afternoon.

Let me begin by trying to get an assessment of the general status of agriculture in Latin America. I want to get some idea of its potential, what kind of resources they have in terms of land and machinery and labor, how much of a competitor of ours these countries are now, what is their potential for being a competitor and adopting the kind of technology that would make them an even more formidable competitor. Give us some idea of the agricultural potential of Latin America.

Mr. SCHUH. I will be glad to take a stab at that.

Representative HAMILTON. You don't need to raise your hand, Mr. Schuh. Just speak right out.

Mr. SCHUH. I've been working in Latin America since 1963. Latin America has a lot of agricultural potential. It is not uniform across the region. The countries that have the most potential obviously are Argentina, Brazil, Chile, Colombia, and Mexico in some parts, although Mexico is mostly a semiarid country.

I think if you look at a country that will be a continuing competitor, you are mostly talking about Argentina. It is a temperate zone country, just as we are. When you move to a country such as Brazil that has very large agricultural resources, then of course you're talking about a semitropical and tropical country, so there is more of an international division of labor between them and us. The things they're going to be good at, we most likely will not be good at. So you can see that through economic growth, a significant growth in trade can occur.

One of the difficulties you've had in most Latin American countries, and continue to have, is the failure to invest in agricultural research and extension services, and the policies that discriminate very severely against their agricultural sector.

Unfortunately, countries such as Brazil and Argentina and Mexico that were strengthening their agricultural research systems, now that they've gotten into the debt crisis, have backed away from that very severely. A country such as Brazil, which hardly ever had any of its scientists come abroad, now is finding its scientists leaving the country at very rapid rates. Not only is the research system declining in quality, but so are the graduate programs that back it up.

Representative HAMILTON. A lot of American farmers seem to have the impression that there is a vast potential down there which they can cut loose and flood the markets and be very, very tough competitors for us.

Mr. SCHUH. I disagree with that. I disagree with it simply because those kinds of arguments assume—they deal only with the supply side of the market and don't recognize that there's a demand side of the market. And if you get a very good increase in agricultural output, you will also increase the demand for agricultural output because that broadens the basis for development in those countries.

Representative HAMILTON. But if they did have additional resources and they did take care of some of these constraints, as you and others have identified in your statements, then you could have a substantial increase in its agricultural production.

Mr. SCHUH. Well, it depends on what you mean by "substantial." Let me give you an example. Brazil, for a 12-year period, brought in something like over a million hectares of land into production each year. It was also getting modest increases in productivity, which gave it a 5-percent increase in agricultural output per year.

Now, with very conservative rates of increases in per capita income, the demand for agricultural output would go up by 6 percent. So the demand would increase faster than the increase in output. And that's the real dilemma these countries face; that their population grows so rapidly that they will have a very difficult time feeding their population.

Representative HAMILTON. Suppose we got debt relief down in Latin America? What does that do?

Mr. SCHUH. I don't think it does very much if you don't get the policy reform that should go along with it. That was my point earlier.

Representative HAMILTON. Do you agree with that, Mr. Paarlberg?

Mr. PAARLBERG. As to what it would do for U.S. agricultural——

Representative HAMILTON. Suppose you had the debt relief problem resolved in Latin America today. What would happen? Would they start importing a large amount of American food?

Mr. PAARLBERG. They would import more, but I don't agree with some of the estimates I've heard that U.S. agricultural sales to Latin America might increase by as much as $3 billion. I think that's an exaggeration.

If you were to go back before the debt crisis—I mean before the unsustainable borrowing as well as before the heavy weight of debt service burdens in the early 1980's, you would find that Latin America was traditionally purchasing 9 or 10 percent of all U.S. agricultural exports worldwide.

Well, today, even at the depths of the debt crisis, they are purchasing 8 or 9 percent. So they aren't too far from their historical share of U.S. exports today.

Representative HAMILTON. Your view is, as you conclude that in the absence of the debt crisis, U.S. farm sales would be larger than they are today. Is that your central position?

Mr. PAARLBERG. Yes, they would.

Representative HAMILTON. Do you agree with that, Mr. Schuh?

Mr. SCHUH. I agree with that, but I would come back and emphasize that debt relief without policy reform does very little for them or for us.

Representative HAMILTON. Would there be a substantial effort down there to improve nutrition, do you think, if debt relief was accomplished?

Mr. SCHUH. No, I don't think there would be, frankly. I think the policy reform which would shift the terms of trade in favor of agriculture would do a lot to alleviate the nutrition problem because it would get more income into the hands of the poor.

Mr. PAARLBERG. I would have a slightly less optimistic view. I believe that macroeconomic policy reforms that increase the earning power of the agriculture sector in Latin America won't necessarily increase dramatically the earning power for food deficit citizens in Latin America.

When we discuss the potential of the Latin American agricultural sector, we have to distinguish its potential to produce crops which, at a certain price level is substantial, from its potential to enrich Latin American citizens. Because of inequitable access to land in Latin America, the agricultural sector doesn't have the same potential of agricultural sectors in East Asia, for example, to employ and to provide income to poor people.

Representative HAMILTON. If you got debt relief in Latin America, do you think that they would take the additional resources made available by that debt relief and put them into agriculture, or would they put into other sectors of the economy? Do you have any judgment about that at all, what they might do?

Mr. PAARLBERG. I think much would depend upon the policy reforms that Ed Schuh has stressed. If they took some of the macroeconomic policy reforms suggested, if they liberalized imports, if they reduced protection to the industrial sector, if they did the things being asked of them, then the debt relief would produce benefits for the agricultural sector almost automatically.

Mr. SCHUH. The bulk of the poor in Latin American countries is in the agricultural sector, and that's where the bulk of the malnutrition is.

Mr. ROSSMILLER. I think it's important to point out, though, that debt relief would have an influence through economic growth and rising per capita incomes on the demand side of the equation. It would have some influence on the supply side of the equation, but it is also important to remember that the agricultural production potential is there. It's there whether there is debt or not.

And so we are really talking more in terms of timing of that potential being realized on the supply side rather than whether or not they will continue to be competitors.

Representative HAMILTON. Congressman Upton.

Representative UPTON. Thank you, Mr. Chairman.

I would be interested to hear from each of you your thoughts with regards to the effectiveness of the export subsidies that our country has, particularly the Export Enhancement Program, and how that might compare with any of the programs that particularly the Latin American countries might have to compete with us in that regard.

Mr. PAARLBERG. The best analysis I've seen indicates that the Export Enhancement Program is ineffective as an export promotion device and cost ineffective from the vantage point of the taxpayers. Only about 10 percent of the bushels of wheat that go out under the Export Enhancement Program are in addition to bushels that would have gone out even with the program.

Many of the bushels going out under the program would have been sold anyway, on commercial terms at a higher price. So EEP is primarily an income transfer to importing countries, and one that is quite expensive to the U.S. Government.

The cost of disposing of each of those additional bushels sent abroad through EEP is higher than the value of the bushels themselves. The dirty little secret of this program is that the Government could dispose of more surplus wheat at a lower cost simply by purchasing it at the loan rate and destroying it.

Now, if EEP were a subsidy to U.S. farmers, then perhaps this would be excusable but, as I say, the Export Enhancement Program is a subsidy to foreigners. It makes food artificially cheap for Russians, Chinese, and Egyptians. And for the life of me, I don't understand why U.S. farmers, at a time of budget constraints, should want their scarce subsidy dollar to go to foreigners rather than to U.S. farmers.

Representative HAMILTON. Why does the American farm community support a subsidy?

Mr. PAARLBERG. This is one of the small but nonetheless important mysteries of political life in Washington. [Laughter.]

Representative HAMILTON. Do you think they misunderstand the program? Do all of you agree—excuse me, Congressman Upton with this observation? The Export Enhancement Program is an income transfer to low-income countries, right? Do you agree with that, Mr. Rossmiller?

Mr. ROSSMILLER. Also to countries such as the Soviet Union. To be a little more specific, on the estimates that I have seen at least, the Export Enhancement Program has been estimated to increase additionality at not more than 30 percent and translates into about $6 a barrel on wheat as a cost to the U.S. Government in disposing of the additional bushel.

You raised a question about whether the Latin American countries had offsetting subsidy programs. I think it's important to point out that Argentina and Brazil in the past have imposed export taxes rather than export subsidies on their agricultural commodities.

Mr. SCHUH. The policy goes completely the other way in Latin America today, except for Chile, which does have about a balanced set of policies. But the rest of their policies all discriminate against their exports, one possible exception being the orange juice exports from Brazil which benefits from their export subsidy to their manufacturing sector. It is not an agricultural export subsidy.

Representative UPTON. Have you done any analysis in terms of what may happen in the future with respect to Europe 1992, which Chairman Lee Hamilton had some great hearings on not too long ago. Also, your comments please on the Free Trade Agreement with Canada which was implemented in January. Here again all subsidies, tariffs, et cetera will be taken off and phased out over the next 10 years.

I know that two delegations in Canada and the United States are meeting to look at grain subsidies to see if there is some imbalance between our two countries in the future.

Have you looked at how the elimination of the grain subsidies of these major trading partners, including Europe as well as Canada and the United States, will affect both exports and imports, particularly with regard to Latin America? Will it help things? What kind of impact will that have?

Mr. PAARLBERG. I think it's correct to say those are both major political initiatives, the 1992 initiative in Europe and the Free Trade Agreement with Canada. The agricultural component of those initiatives is, for different reasons, rather small. The agricultural component of the Europe 1992 initiative is rather small because the EC unified its agricultural markets back in 1962, when they launched the common agricultural policy.

The agricultural component of the United States-Canada Agreement is rather small because the sensitive agricultural issues, especially dairy issues, were for the most part left aside, perhaps to be handled at a later date in the GATT negotiation.

One anxiety I have is that the final significance of the Europe 1992 initiative will be to distract political attention in Europe away from the GATT negotiations and make more difficult the completion of a timely policy reform agreement in Geneva.

Representative UPTON. Mr. Schuh.

Mr. SCHUH. I think I agree with what Mr. Paarlberg has said. There is nothing in either the Canadian-United States Free Trade Agreement or EEC 1992 that has much significance for liberalization of agricultural policy.

Representative UPTON. Do you have any thoughts as to the impact of debt relief relative to a particular country—El Salvador, Panama—and the potential growth in U.S. agricultural exports, versus taking the whole region? If there is one country that we could help with regards to debt relief, what major changes would happen?

Mr. PAARLBERG. I would start with Mexico, not only because it has been a very large importer in the past, and has huge import potential because of large population size and rapid population growth, and, relative to Brazil and Argentina, relatively low production potential. I would also start with Mexico because its debts are huge, and because the policies of the Salinas government over the last year have earned for Mexico priority treatment.

This is a country that has imposed remarkable discipline on its policies; debt reduction for Mexico would not be a compromise of the standards that we apply to Latin America. It would be appropriate recognition of the distance that Mexico has gone, in contrast, for example, to Argentina. It's a country where the reform is of such a nature that once the debt load is off their necks, they could have very rapid economic growth. They have done a lot to liberalize trade policy. Their trade policy is closer to being where it should be than probably almost any other Latin American country, and it is a big market. It is a large market.

Representative UPTON. Thank you.

Representative HAMILTON. Congressman Jontz.

Representative JONTZ. Mr. Chairman, I want to thank you for your hospitality in having me as a guest this afternoon. I commend you for scheduling this hearing on a very important subject for American agriculture. I might note that the House Agriculture Committee did have a hearing just last week on this same subject, so I think it is good for the Congress to be informing ourselves about this issue, and I appreciate the chance to ask a couple of questions this afternoon.

I want to, I think, direct this question to Mr. Paarlberg. If I understand what has happened in Latin America in the last decade, the real income of the population of most Latin American countries has declined significantly. Would you agree that that is true?

Mr. PAARLBERG. Yes, on a per capita basis, dramatically.

Representative JONTZ. And the debt requirements that those nations have and the extent of their gross national product which is going to debt service is one of the factors or the major factor? Is that correct?

Mr. PAARLBERG. Yes, that is correct.

Representative JONTZ. You have expressed some caution about what would happen in terms of increased demand for agricultural products in this country were the debt crisis to be lifted. I guess my question is this: If income were to be restored and the depression of income, which has been the result at least in part of the debt crisis, were to be alleviated, would not that income go for the purchase of food, or where would it go?

Mr. PAARLBERG. Some of it would go for the purchase of more food, including more imported food from the United States. That's why I think a resolution to the debt crisis would be beneficial to U.S. agricultural exports.

My word of caution was directed at some of the exaggerated expectations that can develop if we use the 1981 standard as our starting point. Nineteen eighty-one isn't a reliable standard. As I said, in 1981 oil prices were sky high, so the Mexicans were earning foreign exchange and could spend like sailors. High oil prices meant they were creditworthy and they could borrow. There was a grain embargo going on, so many U.S. sales that would ordinarily go to the Soviet Union were going to the Andean countries; 1981 was the all-time high watermark because of a lot of temporary factors for U.S. agricultural sales for Latin America. It was also a high watermark because of the history of borrowing prior to 1981. So if we imagine Latin America without a debt crisis, we have to go back not to 1981 but to the time when they started borrowing and to the time before the grain embargo and before the temporary oil price explosion. And if we go back to the mid- or the early 1970's, we find them taking not 15 percent of U.S. exports, but closer to 10 percent of U.S. exports.

It is that standard that I believe is a more realistic standard of expectations to Latin America in the long run without a debt crisis, perhaps increasing gradually because the developing countries will gradually take over a larger share of U.S. exports with population growth and with muted demand in the industrial world.

Mr. ROSSMILLER. Let me generalize Mr. Paarlberg's caution. In the long period between 1940 and 1972, there was established a relatively shallow growth rate in our agricultural exports. Between 1973 and 1981, the growth rate was four times what it was during that long historical period, and we have been adjusting down from 1981 back to what I would consider a more realistic long-term trend. It may be somewhat greater than it was during that 1940–72 period, but it is certainly is not likely to ever again hit the kind of rate growth that we had between 1973 and 1981.

Representative JONTZ. When you compare the potential for growth in Latin America compared to Japan or Europe or our other major agricultural customers, you certainly have a population factor at work in Latin America that you don't have in some of the other major segments of our export market.

I guess my question is, how much of the change in income will go into agricultural production? How much of the change in income will go in to increase the standard of living? Does the depressed standard of living at the present time mean that a greater portion of the increase would go into purchasing agricultural goods in Latin America as compared to, again, some of our other customers?

It seems to me that those two factors—No. 1, the rapid population growth, No. 2, the very low level of consumption in Latin America compared to our other markets—would suggest some likelihood of greater growth than what would be the case in the absence of those two factors.

Mr. SCHUH. Congressman Jontz, I agree with you and I want to emhasize a couple of points. I have some real concerns about the world food situation simply because modest rates of increases in per capita income—and I'm talking about rates of increases in per capita income between 3 and 5 percent a year—coupled with the population growth rates in Latin America, imply an increase in the demand for agricultural output of between 4 and 6 percent a year.

Now, if you look globally and ask how many countries have ever obtained increases in agricultural output on that order, you can count them on the finger of one hand. To emphasize that point, the demand for increased agricultural output will be outside those obtained by any of the now industrialized countries at any time in this country.

So the likelihood is that if these economies recover—and they will recover rapidly when they do, because every time there has been this kind of a decline in per capita income the recovery has been rapid—I happen to believe that the demand for U.S. agricultural output as exports will be very strong into the future. The key to realizing that demand is going to be not only debt relief, but I want to keep coming back to the issue of policy reform. If they don't reform the policies, they're not going to go anyplace.

Representative JONTZ. Let me ask a question about policy reform. There seems to be general agreement by all observers that policy reform is necessary, along with debt relief. Last week in the House Agriculture Committee, we had Deputy Secretary Mulford from Treasury and he emphasized the important role of economic reform in the Brady package. But what is troubling to me, or what is of question to me, is what people include under economic reform.

Secretary Mulford spent a lot of time talking about privatization. He spent a lot of time talking about capital flight. I think everybody knows that may be more of a symptom. It's a symptom as well as a cause.

My question is this: What sort of reforms should our government have at the top of the list as conditionality for debt relief? What are the reforms that will do the most good in bringing about sustained economic growth in Latin America? Is it land reform? Is it an increase in the standard of living? Is it privatization? Is it changing the role of agriculture so that it's more export-oriented or less export-oriented?

Would you all give me the two or three reforms that you would put at the top of the list as conditionality for debt relief so that the result would be long-term sustainable economic growth in Latin America?

Mr. SCHUH. I think one has to start with those policies that enable these countries to take advantage of their natural resource endowment. So you're talking about significant devaluations of their currency in most cases, and the elimination of the export taxes on their agricultural commodities. So really, all those things that have to do with shifting the domestic terms of trade in favor of agriculture.

The significance of that is that it broadens the base of the market domestically. I think that privatization is an important part of getting their budget down so they no longer have the inflationary problems they have had, but I think that their realigning their exchange rates and getting their domestic terms of trade right is the key to it.

That then gets to the issue of how can we help them. The reason countries do not undertake those kinds of reforms is that they typically raise domestic food prices for their urban consumers, and when they do that the urban populations come into the streets, with demonstrations and riots, and I have not seen a politician yet who was very suicide prone.

There's an answer to that, there's a solution, which is to provide targeted feeding programs for these low-income groups that suffer most from the policy reforms. We've had those kinds of policies in this country for a long time. They are very possible to be established in these other countries. And I don't think we'll get the reform that we need until we help them with that particular problem.

So that shifting the domestic terms of trade in favor of agriculture is really one of the critical issues.

Mr. PAARLBERG. I can think of one list of reforms. It would include import liberalization, privatization, fiscal and monetary policy restraint to bring down inflation, a social contract to hold wages and prices in check, all this in the context of competitive elections to ensure domestic political support for the reform initiative.

Mexico has done every one of these things in the last 18 months. I think there's a point at which we have to start putting our money where our mouth is. There are countries in Latin America that have gone much further than others, that deserve priority treatment for debt reduction.

Mr. ROSSMILLER. I think we've also all implied that there are a number of reforms that could take place in U.S. policies that would be as helpful to the Latin American indebted countries as some of the policy reforms within these countries. These certainly include such things as our sugar program, our Export Enhancement Program that we've already talked about, and other policies that tend to put a burden on other countries.

That's what the GATT negotiation is all about.

Representative JONTZ. We'll have to have you over at the House Agriculture Committee some day to discuss some of these programs. I appreciate the patience of the chairman. I do have one more question. Maybe it's something we could do in the form of a followup.

Mr. Schuh, when I hear from the producers of soybeans in this country, they tell me a story that's quite opposite of what you're telling me. Their impression is that in fact in order to gain foreign exchange to meet debt requirements, the Governments of Brazil and Argentina have embarked on a number of policies to promote exports. The net result has been growth in soybean and soy meal exports from those countries, from 10 million metric tons to 25 million metric tons a year over a period of 7 or 8 years, and that in fact there is a very good case to be made against both countries in terms of subsidies and unfair trade practices that have resulted from a need for those countries to increase earnings to meet debt requirements, that there has been a change in agricultural production from subsistence agriculture to exports, and that the tax in Argentina is a tax on exporting beans; the tax on exporting meal and oil is very small, the reason for which they want to export a processed product, obviously, instead of a raw product.

Now, why do I hear one thing from them and one thing from you that's 180 degrees different?

Mr. SCHUH. I think you've answered part of the question yourself in what you said about Argentina. What every one of these studies that I've seen do is to totally ignore the distortion in the exchange rate. The cruzardo and the austral have both been grossly overvalued, which is a very large export tax, an implicit export tax.

Now, what the subsidies have done, which both Brazil and Argentina have used, is to channel a larger share of the soybean production to the form of meal and oil. It has not affected the total output of soybeans. In fact, we have a very careful study of the soybean industry in Brazil, and on net, policy has discriminated very severely against the soybean industry, even though it has favored the production of oil and meal.

But I would also emphasize that the stimulus to the production of oil and meal has been so that they have it for the domestic feed industry and not so much for export.

Representative JONTZ. I appreciate your answer. That is quite at variation with what many observers of the domestic agricultural scene have to relate, and I welcome the opportunity to talk to you about it.

Mr. SCHUH. I would be glad to share the study with you, but I want to emphasize the importance of the distortions in the exchange rate in this whole set of issues.

Representative HAMILTON. If I may just pick up on that, I've had handed to me a chart here that shows the U.S. trade share of soybeans, and in 1985–86 we had 81 percent of the market. In 1988–89, we had 64 percent of the market. We've lost a big share of the market in just a couple of years' time.

If you look at the exports from Argentina, Brazil, China, all of them have moved up rather dramatically in that period of time.

Mr. ROSSMILLER. A portion of that result can be attributed to our own agriculture policy which has made it imperative for corn farmers to produce corn in order to preserve their corn acreage base.

Representative HAMILTON. That's your point about program flexibility in your statement earlier. But are you saying that this is not worrisome?

Mr. SCHUH. That set of data in itself is not worrisome to me because I have never really believed that the United States had a comparative advantage in soybean production. What the data show is that our comparative advantage is in feed grains.

Representative HAMILTON. So you don't mind losing some of the soybean market.

Mr. SCHUH. Particularly in light of the fact that corn and soybeans are substitute crops throughout the corn belt, and one does not give up a lot of net income to farmers when you shift from one to the other. The delta area may be a different question, since I believe it is a different competitive situation.

But what we ought to be worrying about is if we start to lose our markets in areas where we clearly have a comparative advantage, which is in the feed grains.

Representative HAMILTON. Are we losing market share there?

Mr. SCHUH. I can't you give an answer right off the top of my head, sir.

Representative HAMILTON. I want to go back to this Export Enhancement Program. Have we any defenders of that out there at all? [Laughter.] No? Nobody likes it?

Representative JONTZ. Will the chairman yield? I'm sorry that Senator Dole isn't with us this afternoon.

Mr. SCHUH. You're going to give us your objective answer.

Representative JONTZ. I would just like to share this thought with the committee. I have asked USDA on more than one occasion for some assessment on the impact of EEP on net farm income in this country, and I am hopeful that that information will be forthcoming. I think it's particularly important as we write the next farm bill if we understand how the investment in EEP as compared to other ways of utilizing the same dollars can impact net farm income positively.

When or if I get that information, I'll be glad to share it with the other members of this committee. Thank you.

Representative HAMILTON. I have another chart here on feed grains that shows that our trade share of the market there is moving up. In 1988-89 we had about 67 percent of the market. A couple of years ago, we only had about 50 percent of the market.

Mr. PAARLBERG. If I could interject a point. On our feed grain share, it's worth noting that our feed grain share has recovered and is moving up, despite the absence of an Export Enhancement Program for corn.

Those who argue that the Export Enhancement Program has been a decisive factor in U.S. recovery of market shares for wheat have to explain why we've done as well or even better in corn when we didn't have an Export Enhancement Program.

Representative HAMILTON. I have a statement here in front of me from a USDA publication, "Why Did U.S. Wheat Exports Expand?" and they have the sentence, "It is estimated that EEP was responsible for about 30 percent of the 1986-87 wheat export expansion."

Mr. PAARLBERG. That's 30 percent of a relatively small expansion early in the history of the program. What we have learned about this program is that the additionality can be fairly high at a time when markets are slack, but when markets tighten, as they have in 1987 and 1988, the additionality shrinks and the cost to the taxpayer of additional sales under the program begins to soar.

Representative HAMILTON. What do we do to get exports up? If you meet with farmers, their conclusion for all of their ills is to increase exports, right? At least that is what I always hear. So what do we tell them? How do you increase exports?

Mr. SCHUH. Exports have been recovering very well the last couple of years as the dollar fell in foreign exchange markets and as general economic recovery began globally. There is the issue of the commodity programs and the extent to which they interfere with our being competitive, and they continue to do that. There is the issue of our continuing to invest in the agricultural research that will keep us competitive, and then the issue of infrastructure which I think does not get the attention in today's world that it deserves. The rural infrastructure in this country is deteriorating rather rapidly.

Those are the three things that are really critical. There is no panacea to any of those.

Representative HAMILTON. What do you mean by the interference of the commodity programs? What do you mean by that?

Mr. SCHUH. What I mean is that people, when they cite our loss of export markets, they go to the first half of the 1980's, the experience from 1980 up to 1985. That had to be one of the worst periods for agricultural commodity programs in our history. Prices were projected upward, completely independent of what market forces were, while at the same time the value of the dollar soared for a 6-year period, from 1979 to the first half of 1985. We priced ourself out of the market, and stimulated output in other countries. That's called shooting yourself in the foot.

Representative HAMILTON. What has been the effect of the 1985 bill?

Mr. SCHUH. The 1985 bill, which lowered the support levels, had a dramatic effect—a very significant effect—on our export performance and probably as much or more effect than what the export subsidies have done.

Representative HAMILTON. What if we are unable to get debt relief for Latin America? What then are the consequences for our exports to the region?

Mr. SCHUH. I think it depends very much on what we do to help those countries reform their policies. I would come back to the issue of helping them with targeted feeding programs.

Representative HAMILTON. What if you don't get any reform? If you don't get any debt relief, you don't get any reform. In other words, you have a kind of continuation of what you've had.

Mr. SCHUH. They are going to languish in slow economic growth and our markets are not going to expand.

Mr. PAARLBERG. There is a point at which, if you don't provide relief, you get debt repudiation. Whether that would come before or after a major political crisis in Argentina or in Mexico might be an open question, but the fear of debt repudiation should concentrate the minds of some commercial bankers who are dragging their feet on debt reduction.

Representative HAMILTON. Suppose you got debt repudiation. How would you see that affecting our agriculture?

Mr. PAARLBERG. Full-scale debt repudiation would be a threat to the financial system, first and foremost, and the collateral damage to the agricultural sector would probably appear on page 45.

Once again, I am not sure that the agricultural trade connection is the key to understanding U.S. interest in the debt crisis.

Representative HAMILTON. All of us here on the Hill are commenting about the importance of environmental matters, and among those concerns are the adverse environmental impact in Latin America of expanding cropland.

Is there any reason to believe that debt crisis and the need to increase exports and reduce imports is a major factor in explaining, for example, the deforestation in Brazil?

Mr. SCHUH. In the case of Brazil, which is often where that issue is raised, the bulk of the increase in soybean production came as pasture was converted into cropland. It did not come with the destruction of forests. The environmental issue is a serious issue in Brazil. It's a far more complex issue to deal with than most people seem to think, simply because it's a huge country and people have the freedom to penetrate into any part of the country they want to. To try to impose limits on whether they cut down the forests or not is like trying to have done it in our own early history. I think it's a very complicated problem.

But I think it'f fair to say that at this point the expansion of the agricultural sector is not the culprit—that exports have not been at the expense of the environment.

Mr. PAARLBERG. I would agree with Ed Schuh completely. The destruction of the rainforest in Brazil is largely attributable to the inflation rate in Brazil, which drives people into investments in land ownership, and the land ownership laws in Brazil which give people a claim to two or three times the area that they clear, so they have an incentive to clear; and, in addition to that, tax rules which forgive from taxation some income earned on agricultural lands. It is more a function of macroeconomic policies, tax policies, and land ownership policies in Brazil than it is a function of any export earning imperative that Brazil might feel.

Representative HAMILTON. You said that the pasture was converted to soybean production, is that right?

Mr. SCHUH. That's right; in the south.

Representative HAMILTON. Does that mean that forests were converted to pasture?

Mr. SCHUH. There was some substitution like that, if you look way up north where there was some clearing of the land for cattle production. But again, that was mostly a response to the fiscal incentives and not to market incentives. Market incentives have been going the other way.

Representative HAMILTON. It appears now that we're not going to get agricultural trade substantially liberalized, at least in the short term in the GATT negotiations. If that is the case, what are the implications for Latin America and debt repayment, or does it have any implication?

Mr. PAARLBERG. I think it does have some implications because the common agriculture policy of the European Community is a major barrier in the path of Latin American agricultural exports. Absent a reform in that policy, Latin agricultural exports will continue to lag.

I think you are correct in assuming that a dramatic breakthrough in the GATT negotiations is not just around the corner.

The European Community isn't under budget pressure at the moment. At the 1988 Brussels summit, they increased their revenue base by 25 percent. They can, for the moment, run their programs without a great deal of added discipline.

Representative HAMILTON. They are very tough on this issue, aren't they—on maintaining agricultural subsidies?

Mr. PAARLBERG. The European Community?

Representative HAMILTON. Yes.

Mr. PAARLBERG. Yes, sir.

Representative HAMILTON. Do you see any chance of really reducing agricultural subsidies in the near future?

Mr. PAARLBERG. I think the United States can increase the chances by keeping our programs under a certain amount of discipline. We have bailed out the European Community in the past by keeping our loan rates high—that was corrected in 1985—by keeping our target prices high, which obliges us to take land out of production in order to protect our budget exposure. Every time we take land out of production, the European Community puts land into production.

If we can get away from the suicidal tendency to idle our own productive resources, if we can produce at lower cost and export at lower cost, that won't hurt U.S. farm income, but it will increase budget pressures on the European Community and speed the process of reform inside the European Community.

Mr. SCHUH. Mr. Chairman, I think the problems with the Uruguay Round of GATT negotiations are far more basic than the agricultural issue. The problem is that we have refused to put on the table the issue of distortions in exchange rate as a distortion to trade. It is probably the most widespread distortion to trade in the international economy.

We have not included, nor put on the table, the discrimination against their agricultural sector that the developing countries do. And so what we are focusing on is problems of access, which is only a very small part of the total picture. It's like negotiating the sale of an elephant by negotiating over its toenail. We're missing most of what's important in international trade relations, and I think a very serious aspect of that is that we're using up a lot of political capital to gain virtually nothing. I think we cannot afford to continue to do that.

Representative HAMILTON. Do you think our emphasis is wrong, then, in GATT?

Mr. SCHUH. We have the problem defined wrong. We are defining the problem strictly in terms of access to markets when the question of discrimination against domestic agriculture, which the developing countries do, is far more important empirically when you look at the global market. And the distortions in the exchange rates are also far more important.

If you don't get those very important issues on the table, you are going no place.

Representative HAMILTON. Do you agree with that?

Mr. PAARLBERG. I do agree with that, but I would go a little further. Even within our narrow definition of the problem, we may have missed opportunities in the negotiations so far, opportunities to discipline export subsidies in particular.

Our own Export Enhancement Program that we've discussed today is, in fact, being phased out. The bonus bushel payments are down to a fraction of what they were a year ago because of the 1988 drought and shrinking Commodity Credit Corporation stocks. In my view, we should have traded away that program last December at the midterm review when we could have still received something for it. Instead, we are unilaterally disarming our export subsidy program while the European Community, with the budget resources available, will continue to provide its own export restitution payments.

We went for the zero option, a complete elimination of all, domestic as well as international, subsidies, and came up emptyhanded. Now the European Community isn't feeling any pressure and our export subsidy program is evaporating. We don't have the leverage anymore. We may get much less in the future than we could have had last December.

Mr. ROSSMILLER. In addition to that, it seems that we have worked out with the other GATT countries an agreement in early April which included a freeze on support levels, and then promptly both U.S. officials and EC officials went home and started saying that agreement didn't make any difference to what they wanted to do.

And so it seems to me that we are backing away from the very innocuous agreement of early April.

Representative HAMILTON. What kind of export subsidies do you support, if any?

Mr. PAARLBERG. I would support export credit guarantees, especially to countries such as Mexico, facing great credit difficulties, financing difficulties.

Representative HAMILTON. Only?

Mr. PAARLBERG. Well, there are some countries like Poland that have——

Representative HAMILTON. No, I mean is that the only kind of export subsidy you would support?

Mr. PAARLBERG. I would consider export subsidies on some highly processed products, where the United States has a small market share and where we can do a little better in an export subsidy war with the European Community. They have to cover much larger markets than we, so our export subsidy dollar gets a little more leverage in the high-dollar value-added markets than in the bulk commodities markets.

Mr. SCHUH. Mr. Chairman, export subsidies are export subsidies. They are income transfer to other countries. Why would we want to do it?

If we want to provide income transfers to other countries, we can do it with much more——

Representative HAMILTON. How do you deal with the argument that if the other countries do it, we're going to be put at a disadvantage and we're not going to maintain market share?

Mr. SCHUH. Well, if other people want to shoot themselves in the foot, let them. There's no reason why we should.

Representative HAMILTON. Do they shoot themselves in the foot if they expand their market share?

Mr. SCHUH. They may be expanding their market share, but they're providing income transfers to other countries. That's inherent in them.

Representative HAMILTON. With any kind of an export subsidy?

Mr. SCHUH. With any kind of an export subsidy.

Mr. PAARLBERG. Some of what the other countries do is purely in response to our export subsidies. The European Community will subsidize as much as necessary to dispose of their surplus stocks.

If we put out more with export subsidies, they'll match our subsidies and go one more in order to push out what they have to push out. So if we were to stop, they would pull back as well.

Mr. ROSSMILLER. To give you some perspective on what Mr. Paarlberg is talking about in terms of numbers, in 1986 fully two-thirds of the cost of the U.S. agriculture program was to offset the programs of other countries. In the European Community it was one-third, and in Canada it was over half.

So a lot of the subsidy war that takes place is, as Ed Schuh says, everybody, all the exporters shooting themsleves in the foot.

Mr. SCHUH. If we were to take this same money and use it to help domestic agriculture to adjust to other production possibilities or to adjust some of the labor force out of agriculture, it would do far more for the economic performance of our economy as a whole than to provide income transfers to other countries. And I think that's the way we have to define the problem.

Mr. PAARLBERG. I would agree with that completely. If the concern today is with drought-threatened wheat farmers in Kansas, the response should be to target our subsidy dollars to Kansas, not to the Soviet Union.

Representative HAMILTON. What if you don't get export growth in the next few years? What are the implications for American agriculture if exports don't grow?

Mr. PAARLBERG. I think they are profound and distressing. The domestic market is growing too slowly.

Representative HAMILTON. It's pretty constant, isn't it?

Mr. PAARLBERG. Yes. Diets are already rich; population growth is negligible; the domestic market grows at about 1 percent a year. Productivity growth in the U.S. agricultural sector is much higher than that. If U.S. agriculture were forced to produce only for the slow-growing domestic market, it would have to start downsizing itself even more rapidly. It would have to start shedding resources—land resources, labor resources, capital resources, in an economically inefficient and politically unacceptable fashion.

Representative HAMILTON. So sum up for me then how you would increase exports.

Mr. PAARLBERG. We're doing it with the 1985 farm bill, and with a lower dollar exchange rate, though perhaps not low enough.

Representative HAMILTON. But not with the Export Enhancement Program?

Mr. PAARLBERG. Not with the Export Enhancement Program.

Mr. SCHUH. But let's get to the basics. I mean some of the basics have to do with our fiscal policy so that we don't have to borrow so much from abroad which gives us such a strong dollar. We need to get more stable monetary and fiscal policies so we don't have all this uncertainty in the economy. These are some of the basic issues.

I'm not at all pessimistic about our ability to compete abroad if we get the right policy configuration.

Representative HAMILTON. What is more important for us to achieve—debt relief in Latin America or trade liberalization through the GATT? As a policy matter for this government, what is most important?

Mr. SCHUH. Trade liberalization by far.

Mr. ROSSMILLER. I'd say trade liberalization because it's going to help in the debt relief eventually.

Mr. PAARLBERG. I should say that is what's most important for U.S. agriculture. For the U.S. economy as a whole, debt relief in Latin America might be more important than agricultural trade liberalization.

Representative HAMILTON. But for U.S. agriculture?

Mr. PAARLBERG. For U.S. agriculture, if you could get liberalization in the European Community, it would produce many more benefits than debt relief in Latin America.

Representative HAMILTON. Does it bother you that we are trying to get trade liberalization through GATT and in effect change the domestic agricultural law of the United States in that matter?

Mr. PAARLBERG. You haven't done it yet.

Representative HAMILTON. Does it bother you that we're trying to?

Mr. PAARLBERG. It doesn't bother me that we're trying. I'm not certain that that's the best way to go about it. If you put all your political emphasis on negotiations in Geneva, you give the Agriculture Committees here in Congress a little bit too much chance to drag their heels and to blame their own reluctance to reform on the alleged unwillingness of our European trade partners to reform.

Representative HAMILTON. I wondered about the strategy. I mean suppose you succeeded in GATT and you got trade liberalization. That doesn't change the domestic law of the United States, does it?

Mr. PAARLBERG. Well, if you got trade liberalization in GATT and the implementing legislation were drafted that were true to that agreement, it would change.

Representative HAMILTON. Well, that's a big "if."

Mr. PAARLBERG. I think you're raising an important point. It's an "if" that our trade negotiators assume. It's an "if" that the Agriculture Committees are reserving judgment on. There might have to be a negotiation between the U.S. Trade Representative and the Agriculture Committees.

Representative HAMILTON. Mr. Rossmiller, I wanted to just pick up a comment you made a few minutes ago about the harm done to Latin American countries by some of our domestic policies, and you mentioned the Export Enhancement Program. You also mentioned the sugar program. Are there others? Sugar, because I guess we prop the price up, basically?

Mr. ROSSMILLER. Sugar, because we have stringent import quotas and don't allow the access; yes. I think that there are others. Any of the commodities programs that we run that would have an adverse effect on the international market are going to adversely affect the exporters of those same commodities from Latin America.

I think sugar is probably the most horrible example. The Export Enhancement Program certainly has affected the price of wheat internationally and therefore the well-being of Argentina.

In some ways it's not only our programs; it's other countries' programs as well. The European Community also runs a sugar program that is detrimental to the sugar exporters.

Representative HAMILTON. You had a statement in your prepared statement about future farm legislation might be designed to assure that program benefits do not become capitalized in the land values and thus reduce U.S. international competitiveness. How do you do that?

Mr. ROSSMILLER. Well, some form of decoupling, I suspect. There have been a number of different proposals in that regard—the Boschwitz-Boren bill, of course, earlier in our history; the triple base program that has just been proposed, I think, by Mr. Stenholm is a movement in that direction.

Representative HAMILTON. What is that?

Mr. ROSSMILLER. It's a program where the last unit of production of any given crop would be produced at world market prices without support.

Representative HAMILTON. Do you think it's likely that the Latin countries will try to block GATT negotiations until they get debt relief?

Mr. SCHUH. They are really not participating all that much in the GATT negotiations. The GATT negotiations have for a long time been a set of negotiations among industrialized countries. It is only recently that they have come in, and their issues are rather different than that. They have to do with intellectual capital and things like that.

Mr. ROSSMILLER. I think what you are getting at there is the fact that the Latin American countries in Montreal led the charge to not ratify agreements in other sectors because agriculture was not agreed to. It seems to me they will hold to that position, since they do have some very strong interests in some of the other sector agreements. If they hold to that position and continue to have the support of the Cairns group behind them, yes, I think that they can disrupt the Uruguay Round if agriculture does not come to an acceptable agreement.

Representative HAMILTON. Mr. Schuh, you said that policies of institutions such as the World Bank have not always been as effective as they could be. Do you want to elaborate on that a little bit in this context?

Mr. SCHUH. Yes, I would. The issue was how to bring about policy reform. If you don't deal with the constraints that limit the policy changes, then you do virtually nothing. And the real impediment to bringing about policy reform in these countries is dealing with the rise in food prices that comes about with the policy mix that you happen to have. This requires targeted feeding programs. We know how to develop those targeted feeding programs. It would be an excellent use of our food aid if we were to do it, and I think that we would make possible the reform by addressing that set of issues.

Representative HAMILTON. So the conditionality they have does not contain the right conditions.

Mr. SCHUH. Exactly. The Bank has not really addressed the constraints to the policy change. I argued that for 3 years inside the World Bank. I made a little progress, but not very much.

Representative HAMILTON. All right. I think that does it. Is there anything you want to conclude with, any remarks for the sake of the record? If not, we are very grateful to you for your appearance this afternoon before the Joint Economic Committee. We thank you for your statements as well as your testimony, and the committee stands adjourned.

[Whereupon, at 3:24 p.m., the committee adjourned, subject to the call of the Chair.]

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