

Government Intervention Affecting Agricultural Trade

Leaflet No. 6

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Agriculture in the United States has long been shaped by federal government attempts to enhance farm profitability through a variety of government programs and policies. Depending on the commodity, the influence of government in agriculture can be traced through regulation, trade protection or promotion, and price and income support programs. Government intervention in agriculture not only affects which commodities and products are produced, but also the volume of imports and exports of many commodities. In the past, some farmers have taken pride in the fact that their commodities were not supported and regulated by government programs. However, today even those commodities are affected by a range of government policies on competition, trade, and the economy.

Agriculture is a part of the world economy. Policies in other countries have an impact on U.S. agriculture just as U.S. policies affect agriculture in the rest of the world. National security and U.S. macroeconomic policies also have significant impacts on farm income and levels of U.S. agricultural exports and imports. The purpose of this leaflet is to highlight the impacts of government intervention on agricultural trade. As government policies change, there are winners and losers and producers of trade-sensitive commodities have both

much to gain and much to lose. An understanding of the potential implications of various government policies is critical to success in agricultural and agribusiness operations and to the development of sound government policy. This leaflet builds on topics discussed in Leaflets 2-5: the economics of trade, trade and the environment, trade and the consumer, and macroeconomics policies and agriculture.

Policy Interventions

Food is necessary for life and to maintain national security. Most governments afford agriculture a special niche in public policy and efforts may be made to stabilize farm prices and incomes, to assure consumers an adequate supply of food at reasonable prices, to attain a degree of self-sufficiency in food production, or to counter interventions by foreign governments in agricultural markets. To this end, most governments intervene in agricultural markets, but the effects spill over into international markets for food and fiber products.

This intervention can be extensive. Policy instruments that influence agricultural competitiveness and trade are outlined in Table 1. The list is surprisingly long and includes many policies not normally associated with trade. Some of the policies listed create trade barriers and others distort trade flows. Some are considered harmful, but others are beneficial. "Some policies such as provisions of agricultural research, extension, infrastructure, environmental protection, grades, and many sanitation standards have favorable benefit-cost ratios and are considered acceptable in world trade policy forums. Other policies such as export subsidies are condemned. Commodity programs designed to reduce food costs or raise farm income often inadvertently influence trade" (Tweeten, p. 49).

Trade Barriers

Direct intervention measures include tariffs and other import taxes, quotas on imports or exports, and export subsidies or taxes. Common trade barriers are defined in Table 2. Financial trade barriers such as tariffs (import taxes) raise the price of imported goods. A non-tariff barrier is any governmental device or practice other than a tariff, which directly impedes the entry of goods into a country or discriminates against imports.

Table 1. Policies Influencing Competitiveness and Trade

Direct Trade Intervention

- Tariffs and taxes
- Import and export quotas
- Export subsidies and taxes

Macroeconomic Distortions

- Interest rates
- Wage rates
- Inflation rates
- Exchange rates

Market Price Support

- Domestic price supports linked with border measures--quotas, permits, tariffs, variable levies, and export restitutions
- Two-price systems and home consumption schemes
- Domestic price supports linked with production quotas
- Government inventory and commodity loan activities
- Marketing board price stabilization policies
- State trading operations

Commodity Programs

- Direct payments - deficiency, disaster, payment-in-kind (PIK) entitlements, stabilization payments
- Producer co-responsibility levies (taxes on commodity to pay for surplus disposal)
- Supply control - marketing quota, acreage diversion, land retirement

Programs Affecting Marketing of Commodities

- Transportation subsidies
- Marketing and promotion programs
- Health, safety and sanitation regulations
- Grading and inspection

Programs Affecting Variable Costs of Production

- Fertilizer and irrigation subsidies

- Fuel tax exemptions
- Concessional domestic credit for production loans
- Irrigation subsidies
- Crop insurance

Programs Affecting Long-Term Agricultural Productivity

- Research and extension services
- Conservation, environmental, and natural resource programs
- Structural programs to adjust farm size and numbers
- Infrastructure -- roads, ports, etc.

Source: Tweeten, Luther, Agricultural Trade: Principles and Policies, Westview Press, Boulder, CO, 1992. Table 2. Definitions of Common Trade Barriers

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BARRIERS TO IMPORTS

Tariff: Also called an import tax or customs duty; may be specific" (a fixed charge per unit), or "ad valorem" (a percentage of value).

- *Variable Levy:* A form of **ad valorem** tariff used to establish a price floor for imported commodities. To be effective, the levy must be equal to the difference between prevailing world and domestic prices.

Tariff-Rate Quota (TRQ): A method of "tariffication" used to convert non-tariff barriers to tariffs. In a specified period, a negotiated rate is applied to imports up to a quantitative (quota) limit and a much higher rate is applied to imports above that level.

Non-tariff:

- *Quota:* Limits the quantity of a good imported during a specified time period.
- *Health and Safety Regulations:* Protect consumers and producers from disease, pestilence and product safety hazards.
- *Temporal Restrictions:* Limits the entry of agricultural products to time periods when the importing country has no domestic production.
- *Limited Ports of Entry:* A commodity is only allowed to enter the country through a specified port facility. Unloading capacity places limits on trade volume.
- *Import Licensing:* Limits the number of firms permitted to trade in specified commodities and may limit quantities imported. Government license fees may be charged.

- *Voluntary Export Restraint (VER)*: Bilateral agreement in which the exporting country limits its exports of a certain product to the importing country under threat of more restrictive actions by the importing country.

BARRIERS TO EXPORTS

Export Subsidies:

- *Direct*: Payments made by governments to exporters to reduce the cost to the buyer, to increase competitiveness.
- *Indirect*: Various domestic programs which have the effect of allowing producers to export commodities below the cost of production.

Export Controls:

- *Tax*: Payments collected on exports by governments from producers or exporters.
- *Embargo*: Suspension of trade with one or more foreign countries; may be commodity specific.
- *Quotas*: Quantity limits imposed on exports of specified commodities during a specified time period. Licensing or export certificates may be required.

Non-tariff barriers are generally categorized as being either quantitative or non-quantitative restrictions. Quantitative restrictions include quotas and licensing, while non-quantitative restrictions include health and safety regulations, temporal (seasonal) restrictions, and limited ports of entry. Some non-tariff barriers serve a legitimate purpose because they protect consumers, but they still may have an impact on international trade flows.

The most common type of trade barrier is the tariff. Tariffs discourage imports by raising the price of the imported good, thus discouraging consumer purchases. Domestic producers benefit from reduced competition and higher prices, and producers in exporting countries are harmed by the reduction in the level of exports.

There are two basic types of tariffs. An ad valorem tariff is a tax calculated as a fixed percentage of the value of the commodity being taxed; a specific tariff is a fixed sum of money per physical unit of a commodity; and a compound tariff is the combination of the two. The U.S. uses both specific and ad valorem taxes in approximately equal proportions. For example, the U.S. applies ad valorem taxes to imports of sweet corn, soybean oil, melons and high fructose corn syrup, and specific duties on imports of tomatoes, fresh citrus, concentrated citrus juice, wheat, barley, corn, tobacco, wine and soybean meal.

The European Union (EU) relies mainly on variable levies to restrict imports of agricultural products. These products include beef, dairy, grains, rice and sugar. Variable levies are ad valorem tariffs that change when world prices change so that internal domestic prices are protected at prescribed levels. For example, if the world price for wheat drops, the EU

variable levy on wheat will rise just enough to offset it. Thus, the EU insulates its domestic markets from changes in world prices and protects domestic prices established under the farm programs of the Common Agricultural Policy (CAP).

Unlike tariffs, which allow goods into a country without limits, provided consumers are willing to pay the price, quotas fix the quantity of a specified commodity that can legally enter a country. Quotas provide protection for domestic producers and penalize consumers by reducing the availability of goods. The likely result is higher prices.

Quotas can have unintended side effects, as illustrated by the U.S. sugar program. Selected countries are each allocated a fixed quantity of sugar which they can legally export to the U.S. These quotas protect U.S. producer prices, which are higher than world prices. Over time, high U.S. sugar prices have encouraged increases in domestic sugar production. Corn growers have become major supporters of the U.S. sugar program because the higher U.S. sugar price resulting from the quota led food manufacturers to substitute high fructose corn syrup (HFCS) for sugar. Therefore, with the sugar program, production of HFCS has been highly profitable; without the sugar program, sugar prices would have been lower and HFCS production might not have been profitable.

U.S. consumers have paid significantly higher prices for sugar and sugar-containing foods as a consequence of the U.S. sugar program. Also, increased domestic sugar production and a loss of market share in the domestic sweetener market have resulted in a tightening of import quotas. Ironically, some of the nations that have suffered the most are the Caribbean nations whose economic development is considered beneficial to the U.S.

Quotas are no longer permitted under the terms of the Uruguay Round trade agreement (GATT-UR), but quotas that existed at the time the agreement was negotiated may be replaced by tariff rate quotas (TRQ). TRQs apply a lower tariff rate until a specified quantity has been imported during a specified time period, and a much higher tariff rate is applied to any imports above that quantity limit. The TRQ is the "tariffication" method used in GATT-UR and NAFTA to convert non-tariff barriers, such as quotas or import licenses, to tariffs. Under GATT-UR and NAFTA, the higher tariff rates on over-quota imports will be reduced gradually over time, as part of the transition to freer trade.

A TRQ is a compromise between producer and consumer interests. It might provide consumers with access to more of a product than they would have under a quota, at a high price, yet it protects domestic producers from import competition during a transition from a protected market to more open market conditions.

U.S. agricultural imports previously restricted by quotas include beef, meat products, processed dairy products, peanuts, and sugar. Other countries also limited agricultural imports with quotas and have replaced them with TRQs. Canada had import quotas on poultry, eggs, and dairy products. Japan imposed import quotas on rice.

A series of trade agreements negotiated under the auspices of the General Agreement on Tariffs and Trade (GATT) have been very successful in lowering tariffs and eliminating

quotas throughout much of the world. As a consequence, other types of non-tariff barriers have become common. Some countries rely on voluntary export restraints (VER's) to control imports. As with quotas, VER's raise domestic prices for the purpose of protecting domestic producers. Unlike quotas, which are global limits on imports, VER's are bilateral agreements between trading partners. The reduction in exports by one country benefits other foreign suppliers not bound by the VER, as well as domestic producers, since both can increase their supplies to meet consumer demand. Countries often agree to VERs under threat of more severe trade restrictions and because they may benefit from higher prices. In the U.S., meat products, automobiles and textiles are among the imported commodities restricted by VER's.

There are many other subtle and not-so-subtle methods that governments use to limit or discourage imports. These include technical standards and market restrictions on grade, size, quality and maturity; import licensing requirements; labeling requirements; health, safety and sanitation regulations; government procurement practices; antidumping rules; countervailing measures; and state trading. These barriers to market access are often highly restrictive. Sometimes this is the intention, as is often reported of the Japanese, but in other instances it may be a lack of organizational ability on the part of the importing country that causes problems for importers.

The stated purpose of health, safety and sanitation regulations is to protect domestic agriculture and consumers from foreign pests, diseases or chemical residues. While these types of barriers are important and legitimate in many cases, they can be used to limit imports. The difficulty lies in differentiating between regulations which legitimately protect a country from biological, environmental and health threats and those that are used only to control quantities imported.

For example, the EU has banned the use of growth hormones in cattle production in member countries and has banned meat imports from animals which have been given growth hormones. This essentially eliminates all meat imports from the U.S., where use of growth hormones has been judged safe. The U.S. has challenged the ban and both sides claim to have a scientific basis for their position. Similarly, the U.S. has banned imports of all fruits and vegetables treated with ethylene dibromide, but other countries disagree with this decision.

There are both reasonable and unreasonable health and safety regulations, depending on your perspective and your interpretation of the scientific evidence, which affect the flow of agricultural commodities and food products in international markets.

Trade-Distorting Policies

Trade-distorting policies include price support programs, commodity programs, marketing programs, and programs that subsidize production costs. U.S. farm programs have a long history, beginning with the Agricultural Adjustment Act of 1933. These programs provided price and income support for the major food grain and feed grain crops, cotton, dairy, and specialty crops such as tobacco, peanuts and sugar. Farm programs for food grains and feed grains required farmers to leave land idle in order to qualify for price and income support payments. Also, farmers were required to produce these program crops every year to maintain eligibility for program benefits. The tobacco and peanut programs imposed production or marketing quotas on producers and limited the areas where these commodities could be grown.

These programs affected the profitability of producing and marketing selected farm commodities, which, in turn, affected the quantities available, commodity prices, and competitiveness in international markets. In most cases, trade policies were needed to make these domestic farm programs workable. Export subsidies were needed to make U.S. wheat, cotton and rice competitive in world markets, and import quotas were needed to protect high domestic dairy, peanut and sugar prices from cheaper imports. However, in a major policy change, Congress passed the Federal Agriculture Improvement and Reform Act--the 1996 Farm Bill--which terminated most of the U.S. farm commodity programs.

The EU Common Agriculture Policy (CAP) includes farm programs for virtually all of the agricultural commodities produced in the member countries. The EU countries used to be major importers of U.S. agricultural products. However, generous price supports have encouraged production increases to the point where the EU now produces a surplus of some commodities, such as dairy products, wheat, and beef. These surpluses are exported but large subsidies are required because EU domestic prices are above world prices. These subsidies depress world prices, to the advantage of consumers in importing countries and to the detriment of competing producers in other exporting countries.

Prospects for Change

Trade barriers and distortions lead to inefficient use of the world's resources, which affects standards of living throughout the world. The distortions in the market change the economic opportunities for producers and consumers. For example, domestic consumers may pay more and have fewer, and perhaps lower quality, products to choose from, while domestic producers make greater profits. Actions by one country that harm other countries often lead to retaliation in the form of import restrictions or export subsidies of their own. These "trade wars" usually result in losses to both nations.

On a multilateral basis, the prospects for removing or reducing trade barriers and distortions are brighter now than they have been for a long time. The GATT-UR agreement was the first to address a wide range of agricultural trade issues, including both trade barriers and trade-distorting farm policies and programs ([see Leaflet 7](#)). The changes required under this agreement are modest but a precedent has been set for future rounds of negotiations.

Unilaterally, the United States, by implementing the 1996 farm bill, or FAIR Act, will effectively dismantle many of its own trade-distorting domestic programs discussed above. The target price-loan rate scheme which, coupled with export subsidies, was a major distortion to world trade, will gradually be eliminated. The pressure to pursue such widespread changes in farm policy emanated from U.S. budget deficits and not from external sources such as GATT-UR.

The United States has aggressively sought free-trade agreements with other countries. The Israeli-U.S. Free Trade Agreement developed in 1984, the Canada-U.S. Free Trade Agreement completed in 1989, the Japan-U.S. Beef-Citrus accord, and NAFTA are examples. NAFTA is discussed in detail in [Leaflet No. 8](#).

However, it is important to recognize that national political and economic objectives generally outweigh consideration of specific impacts on the agricultural and food production sector. It is unrealistic to expect negative international trade impacts on one or more commodities to take precedence over positive benefits realized by politically influential non-agricultural sectors of the economy. Also, international trade policies which favor the larger sub-sectors of agriculture, such as food and feed grains, can be expected to receive favorable federal government consideration at the expense of minor crops.

The Caribbean Basin Initiative (CBI) serves as an excellent example of how broad national policies can affect the competitive position of U.S. agricultural commodities. The U.S. unilaterally enacted the Caribbean Basin Economic Recovery Act of 1983 with the intent of fostering economic growth in 27 small Caribbean countries through trade, economic assistance and tax measures. It was assumed that such growth would enhance national security, as well as other economic and political interests of the United States, by creating more political stability in the region and reducing the chances of unfriendly governments coming into power. The principal component of the CBI is the provision of duty-free access to U.S. markets. Most agricultural products from CBI countries are eligible for duty-free status, which increases their competitiveness in the U.S. market.

Concluding Remarks

In its simplest form, international trade is a relatively straightforward concept. Through trade, countries are free to specialize in the production of those commodities in which they have a comparative advantage. As a result, world production increases and all nations benefit. In practice, of course, international trade is much more complex. Government policies interfere with the free movement of goods and services, causing distortions in domestic economies. Some industries benefit from trade restrictions, others lose. If trade is liberalized, some sectors of the economy will benefit and others may be worse off, even though the nation as a whole benefits.

The U.S. agricultural sector is affected by a broad array of U.S. government policies and regulations, and by the policies of foreign governments. U.S. producers and others in the U.S. agricultural sector have a vested interest in monitoring and analyzing new trade-related policy proposals, in order to be represented in the government policy formulation process, to anticipate impacts, and to be able to adjust quickly to change.

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