Reforming Farm Subsidies and Trade Barriers

On June 8 the Cato Institute hosted a Policy Forum, "Down on the Farm? Assessing the Prospects for Global Agricultural Trade Liberalization." Participants included Thomas Lambie, president of the Federated Farmers of New Zealand; Jennifer Brant, trade policy adviser to Oxfam America; and Dan Griswold, associate director of Cato's Center for Trade Policy Studies. Excerpts from their remarks follow.

Thomas Lambie: I'm happy to tell you about our experiences in New Zealand as farmers have moved from an environment in which we were subsidized and the government dictated the type of agriculture we performed to today when we farm without subsidies.

Let me take you back to the 1950s when there were worldwide food shortages after World War II. New Zealand was an agricultural nation feeding the United Kingdom and had the second-highest per capita income in the world. We were incredibly rich. Farmers dominated the government. We had it made.

What did we do? We were our own worst enemy. We went to the government and we said: "Prices fluctuate. The climate affects us. We think you should step in and help regulate what we earn, to take away fluctuations in our income." And the government, being full of farmers, said: "Yep, that's good. We'll help you." So the government set up a whole lot of structures that put constraints on the farming community and tightly controlled production and prices.

Worse, the government did not believe the future of New Zealand was in agriculture. So it started imposing import tariffs and quotas on manufactured goods. The aim was to increase the prices of imports and make manufacturing in New Zealand competitive. We locked out everybody, we created lots of jobs, and we had virtually no unemployment in New Zealand right up to the 1970s. We were rich enough, because of the agricultural income that was coming in, to sustain the manufacturing jobs. But our trade barriers started to build a whole lot of costs into the New Zealand economy.

Then we experienced two major economic shocks. The first was in 1973 when Britain entered the European Union. Suddenly, the market that used to take 90 percent of everything we produced was no longer going to do so. The second was the oil shocks. Inflation started to get out of control.

Unfortunately, the government's response was "Agriculture, you must be our savior. Since the balance of payments is getting pretty bad, we need you to produce more than you did before." The agricultural community got assistance, and we were compensated for the costs we faced in our own domestic market. It took us 10 years to go broke. In 1984 New Zealand had no more money, huge government deficits, and huge government borrowing overseas.

Federated Farmers realized that going to the government and always looking for more handouts wasn't working. We were becoming increasingly uncompetitive in world markets. We said to the government, "Strip out our subsidies, but we want you to reform the rest of the New Zealand economy as well."

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Thankfully, the government had little choice. After enduring the pain of a six-year transition, we now live in one of the most deregulated economies in the world. Other than a few tariffs on shoes and on some clothing, our borders are completely open to everything. Responsibility for farming has come back to the farmer.

One positive result of the reform process was that farmers began to better fit their agricultural production to the type of land that they farmed. If you don't get a really good fit, then you can't get your costs low enough to be competitive or you use your resources inefficiently. New Zealand has reduced the number of sheep from 80 million to 40 million, but we produce the same amount of sheep meat. We increased our dairy herd from 2.5 million cows to more than 5 million in response to the market demand for protein products. We've seen a huge diversification of land use in the last 20 years.

Before 1984 the New Zealand farm sector had a productivity increase of less than 1 percent a year. Since the reform it's been more than 4 percent per year. We're performing better than any other part of the New Zealand economy. The agricultural sector in New Zealand has actually grown as a percentage of our GDP. That is almost unheard of in any other developed country. So we're actually doing our part and more for New Zealand.

Another positive outcome of liberalization is that it allows us to focus on the consumer. We want liberalization in trade so we can talk directly to consumers in individual countries. It's not about world trade; it's about reaching out to each country's individual consumers and supplying them with what they want. I've been at the World Farmers Congress of the International Federation of Agricultural Producers for the past week. A theme I heard often was that exports are good while imports are bad, and that when you liberalize world trade it's a race to the bottom.

Well, in New Zealand we are in a race to the top. But every time we reach the top, a bureaucrat somewhere else in the world tries to squash us. The classic example was in Europe, to which we tried to export spreadable butter. The demand from the consumer was astronomical, but because our product didn't meet the regulators' specifications for butter, they stopped its importation. We were providing what the consumer wanted, but a bureaucrat said, "Ah, but it's not butter, because it is too soft." That is the type of issue we want to deal with in global negotiations.

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of people in our noncompetitive protected industries were put out of work, New Zealand probably lost 100,000 jobs. Since then, the move toward a completely open economy has created up to 700,000 jobs. For a small country of four million people, that's a lot of jobs, and we're still creating more. There are many myths about trade being bad for jobs, but we've found the exact opposite to be true.

Jennifer Brant: I am going to talk about the impact of subsidies on developing countries. We at Oxfam think trade can be very positive for economic development. However, trade is not living up to its potential, in part because of unfair trade rules that favor the interests of developed countries over those of developing countries.

A major reason is the problem of dumping—the export of agricultural products at below the cost of production. Small farmers in developing countries depend for their livelihood on the income they earn on their crops. Anything that decreases prices decreases their earnings. And where people are already facing extreme poverty, dumping is extremely detrimental to their standard of living.

Dumping is made possible by subsidies in rich countries that generate overproduction of crops. It is also made possible by liberalization in the importing country. Developing countries have been pressured by international organizations to liberalize their markets. In many cases they have opened their markets to floods of cheap subsidized goods. That has had a devastating impact on small farmers. We have documented the wiping out of the dairy sector in Jamaica by cheap subsidized milk imports from the United States. The same occurred with rice in Haiti.

The average cotton farmer in West Africa earns about $400 a year. And he is part of a better-off group in West Africa who get to farm what they call white gold. It was a very lucrative crop until prices started declining. When you compare a West African cotton farmer's annual income of $400 with the $250 in subsidies that U.S. cotton farmers get *per acre,* you can see that we are talking about completely different worlds.

The International Cotton Advisory Council has estimated that, because of U.S. subsidies, prices were depressed by about 25 percent. And yet, while prices fell in the late 1990s and early 2000s, U.S. cotton production and its share of export markets continued to increase. That is because cotton farmers in the United States are isolated from many international price signals.

In West Africa about 10 million to 11 million people depend either directly or indirectly on cotton for their income. We estimate that about a quarter of a million people in Benin were pushed below the poverty line as a result of price depressions caused by U.S. subsidies. In 2001 Benin lost $33 million in export revenue because of lower prices. That is twice the U.S. aid Benin gets.

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It's just not fair when poor farmers in developing and less-developed countries are asked to compete with the U.S. Treasury. They cannot compete. Even worse, producers in West Africa are much more cost-effective cotton producers than American producers. They produce cotton at about 21 cents a pound, versus 73 cents, which is the average production cost per pound for an American farmer. They are more cost efficient, yet they cannot compete because U.S. producers have access to huge subsidies.

A lot of people ask us: “How can you be against subsidies? They are helping the small family farmer in the U.S. stay alive.” Our research reveals that this is not really the case, that subsidies overwhelmingly go to big agribusiness corporations and corporate farms. In 2001 the poorest 50 percent of U.S. farms received only 5 percent of U.S. subsidies. It is clearly a very unequal system.

Although we are often very critical, we do believe in the multilateral trading system. We think it is the best place for developing countries to get a good deal. We were supportive of the Doha Round. We thought Cancun was a terrible missed opportunity.

We do, however, think a number of things are essential to getting a good outcome from this round. First, the United States and the European Union have to make serious commitments to reduce export subsidies and trade-distorting domestic supports. Second, we think special and differential treatment will be an essential component of a pro-development outcome of the round. The poorest WTO members should get duty-free and tariff-free access to rich-country markets. And they should be exempt from reduction commitments—and frankly any commitments—in this round. Finally, we urge the United States and the EU to comply with the panel decisions that are coming out on cotton and sugar. That will send an important signal that they are still committed to true reform and that they are committed to the multilateral trading system and the rules that govern it.

Dan Griswold: I would like to start by taking exception to the whole way we talk about trade in the context of the World Trade Organization. Trade reforms like those in New Zealand, like those that we have been advocating here at Cato, are not “concessions” that one country makes at its own expense for the benefit of others. Trade liberalization, as New Zealand has seen, is its own reward. When a country liberalizes, it is the first and biggest beneficiary. Its consumers enjoy lower prices and more choice. Its taxpayers get relief from ongoing subsidies. And yes, farmers themselves can produce and promote commodities for real customers.

Of course, other nations do benefit when

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we liberalize. Farm subsidies and trade barriers in the United States and other rich countries stimulate overproduction. That drives down global prices. Consumers in poor countries do benefit from the lower prices, but because many poor countries have a comparative advantage in these commodities—sugar, corn, cotton—there are more producer interests who lose from lower prices than there are consumer interests who gain, and thus the actual income of those countries is depressed. I commend Oxfam for turning the spotlight on this very uncomfortable fact.

Let me offer three quick examples of the damage done by U.S. subsidies and trade barriers. First, rice. U.S. farm policies drive down global prices by subsidizing domestic production of rice, depressing domestic demand for imported rice to the point where the United States is a net exporter of rice. A study published by the National Bureau of Economic Research looked at child labor rates in Vietnam as a function of rice prices. The researchers found that as rice prices went up in Vietnam, child labor dropped significantly. So by driving down the global price of rice, our farm policies are taking boys and girls in Vietnam out of the classroom and sending them into the fields to try to make up for that lost income. The Vietnamese do not love their children any less than we do; it's simply a matter of survival for a lot of families.

Second, sugar. The U.S. sugar program keeps the domestic price of sugar at levels three times the global spot price, through a system of domestic price support loans and quotas. The sugar program extracts somewhere between $1.5 billion and $2 billion a year from the pockets of consumers who buy sugar directly and indirectly in sugar-containing products. It also hurts U.S. industry by driving up the cost of the main ingredient used by U.S. confectioners, forcing many of them to relocate to countries like Canada, where they can import sugar at the global price. Tens of thousands of workers in the Chicago area and elsewhere have lost their jobs because of our sugar policies. And our sugar subsidies are an embarrassment in international negotiations. They make the United States look hypocritical in our calls for liberalization abroad.

Third, cotton. Let me take a little different angle than Jennifer did on this. Our cotton policies are indeed an expensive domestic failure, but they are also a blight on U.S. foreign policy. Look at Mali in West Africa. Its farmers scratch out a living, earning the equivalent of $850 a year. Half of Mali's exports to the world are cotton, grown along the Niger River that flows through what is otherwise a desert country. Mali is one of only two Muslim-majority countries that are rated “free” by Freedom House. Mali has a functioning democracy with respect for human rights. Mali is already the kind of example for the Muslim Middle East that we all hope Iraq will one day become.

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And how has the U.S. government acted to encourage freedom and development in this Muslim country of 11 million people? Well, our cotton subsidies depress the world price of cotton, driving thousands of already impoverished Malian farmers off the land. According to the World Bank, U.S. cotton subsidies cost Mali and its desperately poor neighbors in sub-Saharan Africa $250 million a year. That is a lot of money in that part of the world. That can only add to the frustration, despair, and anger that are rife in Muslim nations today. And we wonder why we have such a hard time winning friends in that part of the world.

Now, Oxfam says that these policies benefit the rich countries at the expense of the poor. I disagree—it is a losing proposition all around. In fact, people in the rich countries are the chief victims of these farm policies. According to a study by the International Monetary Fund, if the rich countries eliminated all these programs, global welfare would rise by $100 billion, but 92 percent of that would go to the rich countries. Rich countries can do themselves a favor by getting rid of these terrible programs and following the example of New Zealand.

So Oxfam and other nongovernmental organizations do stand on solid economic and moral ground when they criticize rich-country trade barriers. But I think Oxfam's critique is incomplete to the extent that it ignores or excuses barriers to trade in agriculture in poor countries. Typically, the highest trade barriers that exporters from poor countries face are the barriers put up by other poor countries, not by rich countries.

The IMF study I mentioned a moment ago found that while poor countries would certainly benefit if we got rid of our trade subsidies and trade barriers, the poor countries would actually realize more than twice as much in benefits if they got rid of their own subsidies and trade barriers. If a WTO agreement exempts poor countries from liberalization under the special and differential provisions, we will be aiding and abetting dysfunctional trade policies that are keeping poor countries poor.

Some observers argue that we need to hold on to these subsidies and trade barriers as a bargaining chip with the rest of the world. But I think our subsidies and trade barriers tarnish our most valuable chip—American leadership. Look at New Zealand—a tiny country of three and a half million people on the edge of the world. They box far above their weight in international negotiations. Imagine the example the United States could set and the leadership it could exert if it got rid of all its trade restrictions. ■