ESSAYS IN INTERNATIONAL FINANCE

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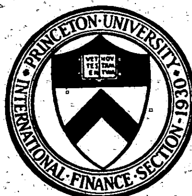
CURRENT ISSUES IN COMMODITY POLICY

BORIS C. SWERLING



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

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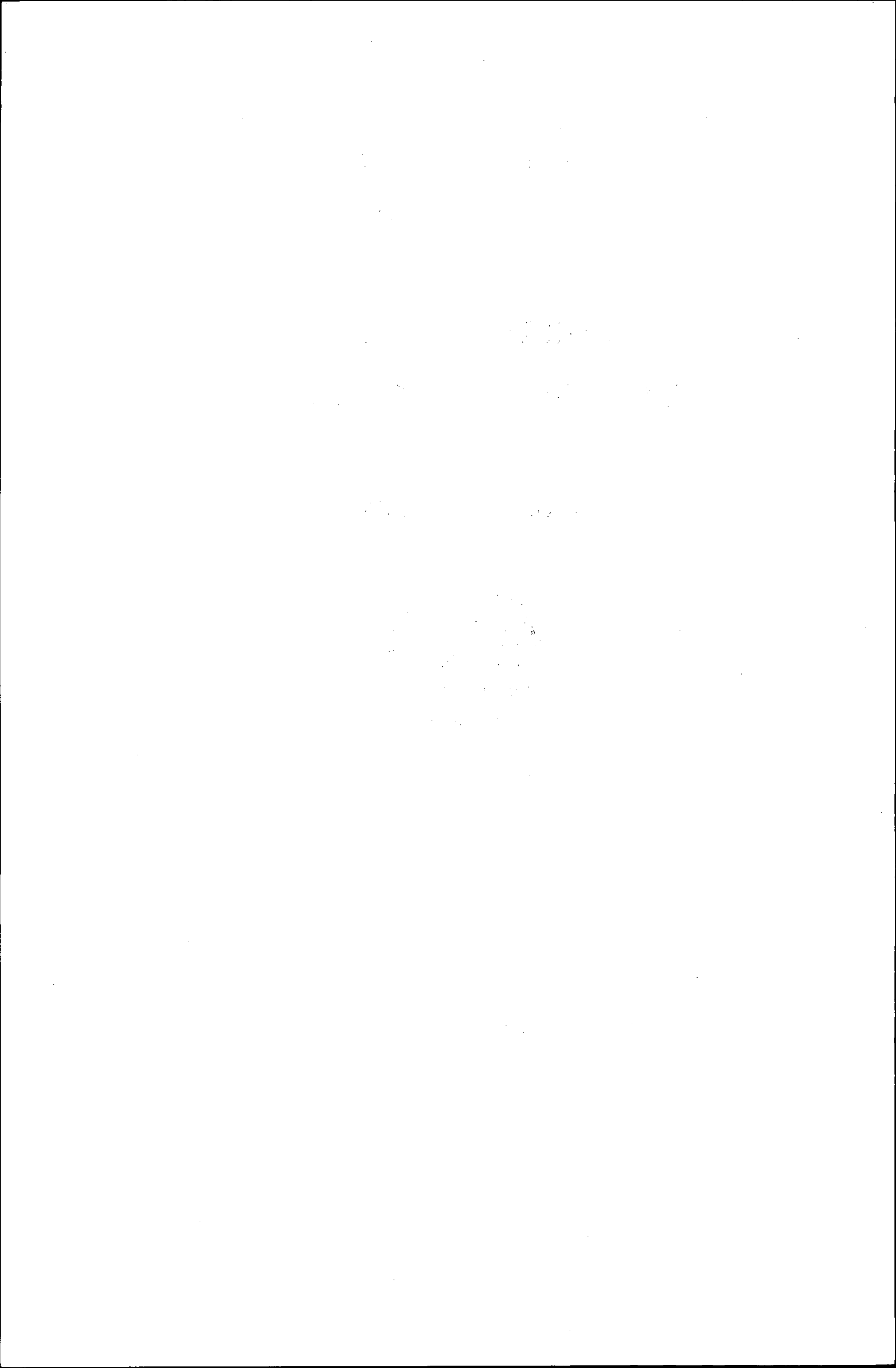

CURRENT ISSUES IN COMMODITY POLICY

THE treatment of primary commodities poses particularly difficult problems for public policy in the industrial societies of the Western World. Formulation of a common agricultural policy has confronted the original six members of the European Economic Community with one of their severest tests, and complicates the possible admission of the United Kingdom. Historical over-representation of the countryside in legislative bodies inhibits reform of discredited farm policies, in the United States as well as elsewhere. Western Europe is so heavily deficient in domestic supplies that its commercial policies over a broader range of industrial raw materials tend to be less restrictive, though petroleum imports create special problems for the traditional coal regions. A more diversified resource base in the United States places domestic commodity groups more frequently in competition with imported supplies, and extends the list of troublesome products. The Western region seeks public favors for its non-ferrous metals and silver as well as its wool and sugar; imports of petroleum encounter the combined opposition of domestic petroleum and coal; the Southern States are less interested than formerly in a liberal trade policy that promoted exports of raw cotton, and are extremely sensitive to textile imports that compete with their local industry. Members of Congress who espouse liberal political causes simultaneously endorse import quotas or tariffs for individual primary commodities; and those who defend financial orthodoxy, exchange-rate stability, and a balanced budget in the interest of a sound dollar are major defectors on the issue of commodity price supports.

Because the economies of the less-developed countries are so strongly oriented toward export of primary staples, commodity policies have a special relevance to many current problems of foreign relations. It is impossible to ignore the importance of petroleum in the politics of the Middle East; the interest of Southeast Asian countries in rubber, tin, and rice; the pivotal role of coffee among Latin America's exports; or the position of vegetable-oil seeds, cotton, and copper in the economy of particular African nations. The market fortunes of individual products significantly affect the foreign-exchange resources available to less-developed countries for implementing long-range programs for economic

improvement while, at the same time, rampant nationalism in newly independent nations is a continual source of disturbance to commercial markets for world-traded commodities.

The enlarged representation of less-developed countries within the United Nations' membership, by increasing the political leverage of commodity interests overseas, is requiring new accommodations in American policy. By 1958, the Eisenhower Administration had terminated its boycott of the Commission on International Commodity Trade, first established by the Economic and Social Council in 1954, and began to lend a more responsive ear to proponents of international commodity agreements. Particularly in connection with Latin American problems, the new Administration has announced its receptivity to international commodity proposals and has aroused hopes of constructive action. Cocoa and coffee, sugar and wheat, petroleum and lead, tin and bananas do not exhaust the list of products for which international controls exist or are seriously under consideration. The risk is ever-present that the General Assembly, responding to the peculiar democratic calculus of one-country one-vote, will urge precipitous actions and false remedies for complex commodity problems.

Unless new approaches and instrumentalities can be devised in the liberal tradition, the cost to the United States in money and intangibles will be heavy. Certainly nothing could be more unwise than to extend to the international arena the discredited and self-defeating commodity programs that have been operated at home. On the one hand, there is need for wider understanding of the external impact of domestic commodity policies; and, on the other, official review of international commodity measures may lead to certain operational guidelines whose relevance to needed domestic reforms will be too obvious to deny. If the United States does not itself honor the economic precepts and accept the requisite disciplines of a democratic capitalist order, we undermine our own efforts to win men's allegiance in the struggle with Marxist ideology and Communist economic programs.

Trade and Agriculture: Export Considerations

With farming now providing less than 4 per cent of the U. S. national income, the macroeconomist is inclined to regard the sector as of minor importance. That judgment is considerably altered if one focuses on U. S. foreign commerce. Shipments of U. S. farm commodities continue to contribute about one-quarter of our merchandise exports. From an international viewpoint, the major dilemmas of American farm programs arise out of the differential between artificially-maintained domestic prices and the lower prices prevailing for commodities traded in

world markets. The differential requires, on the one hand, various kinds of disposal programs to ensure the export of commodities that would be sold abroad even under free-market conditions and, on the other, tight import restrictions even against products that would not ordinarily be imported into the United States on a strictly commercial basis. Well below half of total exports in fiscal 1961 were comprised of hard-currency sales unsubsidized by the Federal government.

Great ingenuity is being employed in the search for constructive outlets for America's agricultural surpluses, particularly under the Agricultural Trade Development and Assistance Act of 1954, as amended (P.L. 480), whether to meet emergency food requirements or to advance the economic progress of less-developed countries. Rapidly developing countries do have an expanding need for raw materials and food, as well as capital goods, and food may in particular instances be a limiting factor on the rate of general economic growth. Availability of surplus commodities from abroad can on some occasions supplement the kind of project-oriented loan that is issued by the World Bank; on others, it will substitute for emergency borrowing from the International Monetary Fund. Additional resources are enjoyed by the economy; pressure on domestic price levels and the balance of payments is relieved; foreign exchange may be spared to finance other needed imports; a higher level of domestic investment can be sustained; and resources can be shifted to other uses. These and other immediate advantages to the recipient nations can, however, carry longer-term penalties if utilization of imported food and fiber delays the technological transformation of indigenous agricultures, or reduces the incentive to cope with intractable population problems. Programs that supply surplus American food to the world's poor, while simultaneously promising to accelerate economic advancement abroad, make so strong an appeal to our hopes and to our sense of common humanity that rational criticism at home is almost silenced by noble purposes.

Considering the heavy volume of export sales at concessionary prices and the long list of commodities involved, foreign objections to U. S. activities have been surprisingly moderate of late. In part this is because consultative procedures have been developed that remove some of the fear of the unknown and may perhaps also have saved the United States from making some serious blunders. There are other reasons as well. Two commodities experiencing particularly dramatic growth trends since prewar days, inedible animal fats and poultry meat, have moved very largely on a strictly commercial basis. Feed grains are another commodity group showing spectacular expansion in U. S. export shipment. While export subsidies have played some part, the chief incentive

was the need to fill the gap in world supplies of corn that resulted from the disappearance of Argentine supplies in the early postwar period. In wheat, rice, and soybeans, world food shortages similarly justified enlarged American crops in the early postwar years.

In part, the moderate degree of foreign criticism is explained by the impact of U. S. price supports on competing exporting countries, especially those in the less-developed category. For cotton and tobacco, two commodities in which competitive relations with less-developed countries are most direct, domestic programs have operated on balance and inadvertently in favor of foreign areas of supply. In effect, the U. S. price support has acted as an umbrella, placing the supply control necessary to enforce that price largely upon American producers while other countries have won a rising share of the market. For tobacco, surplus stocks have largely been avoided, and export subsidization to date has been minor. Concessionary sales of cotton have operated on a much more substantial scale, including more than one billion dollars under P. L. 480 financing, a peculiar kind of "food" for peace. The United States has, however, served as residual supplier of upland cotton, enduring substantial year-to-year swings in exports in response to variable consumption requirements abroad and changes in U. S. export policy, while less-developed countries have for the most part been able to dispose of their crops on a current basis. Particularly for cotton, probably no single step would have been more disadvantageous to competing exporters than a downward revision in the U.S. price appropriate to the full potential of postwar cotton technology.

The individual commodity most heavily subsidized in aggregate has been wheat (including flour), cumulative sales of which under P.L. 480 alone exceed $4 billion. Several factors here have worked at cross-purposes: (a) The United States has undoubtedly earned much more than its historical share of this market, although the exporting countries suffering most serious disadvantage (such as Canada and Australia) are hardly in the low-income group; (b) less-developed countries seem to welcome large quantities of P.L. 480 wheat, which far more than compensates them for the unnecessarily high price they must pay for wheat purchased on the commercial market; (c) to the extent that subsidized wheat has made permanent inroads into oriental markets, there have been changes in tastes adverse to the rice-exporting nations of Southeast Asia.

Some of these more agreeable judgments have to be considerably qualified in the light of higher support levels established for 1961 crops. The rise in price supports for grains comes at a time when the most serious consideration is being given to the level of agricultural protec-

tionism that will prevail within the European Economic Community, a matter of extreme importance to the potential commercial market for American grain. The United States can hardly be persuasive in arguing for European grain prices to be closer to world market levels if it widens the gap prevailing at home. Competing exporters might have expressed more serious concern had there not been concurrently an enormous increase in the grain purchases of mainland China, a traffic from which the American products were excluded by virtue of the prevailing trade embargo. In the case of soybeans, a sharp rise in support level helped create a new surplus commodity, whereas moderate shipments under P.L. 480 had previously discouraged holding of year-end carryovers even of prudent proportions. Competitive relations with the tropical exporters of copra, oil-palm products, and peanuts, can now be expected to become more embarrassing.

It may nevertheless be contended that the main victim of surplus-disposal operations is not competing exporters but, by subtle lines of causation, the United States itself. Success in moving surplus stocks abroad removes some of the pressure for correcting domestic agricultural programs; in ignoring the criteria of prices and costs, a technocratic approach exaggerates the efficiency of agricultural production; and budgetary burdens stand sufficiently high to restrain federal outlays in directions more appropriate to society's needs or even to the best interests of distressed farm people. To the extent that foreign aid is warped to favor agricultural exports, surplus capacity in capital goods industries may be under-utilized as compared with visible surpluses of agricultural staples. The needs of the world's underfed people, and the "protein gap" abroad, which might justify some change in the product mix of domestic agriculture, become rationalizations to excuse even heavier subsidization of the farm sector through increased price supports for the commodities having more favorable surplus-disposal prospects. The U.S. is gradually maneuvering itself into a position where it becomes committed to unlimited food relief anywhere in the world at close to a zero price. The attempt to fulfil such an obligation could strain the capacity of the U.S. Treasury, if not of American agriculture, and is as likely to earn the resentment of the world's poor as their goodwill.

Particularly in dealings with the underdeveloped world, what is under test is the viability and flexibility of the liberal institutions of Western civilization. "Sales" for local currency are a mockery of the kind of commercial market transactions we presumably seek to foster. At a time when we urge institutional reform upon the leaders of underdeveloped societies, the United States demonstrates its conspicuous inability to cast off a discredited agricultural policy. Our advocacy of fiscal

integrity is hardly furthered by the legerdemain by which the price-support losses of the Commodity Credit Corporation (CCC) are understated or disguised. Nor is the gross inconsistency between our surplus disposal operations and our own anti-dumping laws lost on perceptive foreigners.

So long as the federal government finances so large a share of agricultural exports, the farmer interest in a liberal trade policy as a means of financing farm exports tends to be undermined. So long as agricultural input industries are attached to the full-scale utilization of domestic agricultural capacity, they will assume less than their optimum role as potential agents of agricultural transformation and modernization abroad. And so long as bilateral transactions are given so high a degree of respectability, there will be incentives to extend 480-type devices to a widening list of commodities and a larger portion of our trade—with broad principles of multilateralism meanwhile undergoing a quiet erosion.

Trade and Agriculture—The Effect on Import Policy

The Congressional popularity of barter transactions is one illustration of unwise directions in which these practices lead. As typically practiced by the CCC, barter is not government-to-government swapping that represents reversion to a pre-money economy, but is instead a highly sophisticated commercial transaction. In practice, the barter contractor has taken up some quantity of surplus agricultural commodities for export, and the CCC has agreed to accept specified quantities of a named imported raw material in return. The double transaction has widened the contractor's opportunity for trading profit and accordingly permitted him to shade the price he charges for the export commodity in direct competition with ordinary commercial sales. Essentially the CCC has created a supplemental demand for the imported raw material, partially on the pretext of national security needs. In the specific case of lead and zinc, agricultural surplus disposal accordingly helped support world market prices as an indirect aid to domestic mineral producers, with some incidental saving of storage cost. But the transmutation of agricultural inventories into minerals contributed to the excessive level of strategic stockpiling, which has itself become a subject of official Congressional investigation.

While barter in this form was advantageous to the level of U. S. imports in the 1950's, tight import restrictions are the more characteristic result of the price-support program. The most contentious restrictions, those on dairy products, involve the output of countries like Holland, Denmark, and New Zealand, with their distinguished commitment to

canons of economic efficiency and liberal trade to which we sometimes appear to pay only lip service. Under Section 22 of the Agricultural Adjustment Act of 1933, as amended, the President is required to impose import quotas or fees whenever a farm product is being or is "practically certain to be" imported in a quantity or manner such as to interfere with a domestic agricultural program. That statutory requirement necessitated an agricultural exemption to the general "no-quota" rule of the General Agreement on Tariffs and Trade (GATT) as originally negotiated, reinforced in 1955 by an unlimited waiver for any existing or future actions under Section 22. In effect, the waiver was a unilateral privilege granted the United States, that violated the balance of rights and obligations negotiated under the GATT and jeopardized future efforts to free agricultural trade from governmental restrictions.

Clearly, the higher the level of domestic farm prices relative to those abroad, the tighter must be the import restrictions at the border. From that viewpoint, the rise in 1961 price supports for raw cotton is especially significant. Higher raw material costs for the domestic textile industry, and a wider differential in favor of foreign mills, has increased the protectionist sentiment of a major domestic industry. It is, moreover, an industry subject to strong commercial pressure from the synthetic fibers and of special concern to Southern Congressmen whose votes must be relied upon for enactment of the Administration's trade-liberalization program. To forestall emergent protectionism, "voluntary" export quotas on textile shipments to the U. S. market were imposed by Japan several years ago, a control system that operated to Japan's own disadvantage as large increases occurred in shipments from other overseas sources, especially Hong Kong. Concern for the level of textile imports, for equalizing burdens among exporting countries, and for enlarging foreign outlets for the industrial exports of less-developed countries, brought U. S. initiative in the negotiation of an international textile agreement, now in force.

The latest phase of the cotton issue is the Section 22 hearing conducted by the Tariff Commission with a view to imposing on the raw-cotton component of imported textiles an import fee equivalent to the 8½-cent-per-pound subsidy paid by the United States on the export of raw cotton. To the American textile industry, imposition of the fee seems only a matter of common justice, removing an unfair competitive disadvantage. To Japan, however, the fee is regarded as an exorbitant burden on a trading relationship already strained by the voluntary export quotas, by the failure of certain Western countries to accord Japan full status under GATT, by self-imposed limitations on trading with the Chinese mainland, and by adverse U. S. tariff action on other

commodities. Japan is, moreover, the leading importer of U. S. agricultural products, currently exceeding even Great Britain and Canada, and utilizes far more American cotton at home than it exports in the form of textiles to the United States. Imposition of the fee would unilaterally alter the commercial relationships negotiated to date, and would in effect transfer a portion of earned export proceeds from foreign hands to the U. S. Customs.

The import-fee controversy does open up the possibility of one novel approach. One purpose of the GATT is to promote *quid pro quo's* among trading nations, whether in the reciprocal lowering of trade barriers or when nations backslide by unilaterally revoking concessions previously granted. It would be consistent with that philosophy if collections from a cotton import fee did not accrue to the U. S. Treasury but instead reverted to the governments of exporting countries, so long as local textile industries were not awarded special subsidies. This may sound like a highly unrealistic suggestion, but it has at least one close parallel and is in the spirit of measures increasingly widely applied. To offset the competitive disadvantage of Belgian agriculture, the Netherlands has imposed a levy on the export of low-cost farm produce to its Benelux partner, and the proceeds have been shared between the two countries [10]*. Financial settlements of a comparable sort have taken on a current importance in the context of the European Economic Community. For one thing, there is the plan for an agricultural fund which will gradually take over part of the public expenditures aimed at supporting national agricultures. Proposals gradually to abolish the preferences of African territories associated with the Common Market have also incorporated the technique of compensatory transfers of funds, while there has been increasing attention to the regressive income redistribution among nations that occurs as the result of high fiscal levies imposed in Europe on such tropical products as coffee, tea, and cocoa.

U. S. Sugar Quotas: A Discredited System

For a number of major commodities from the tropics, the only limitation on U. S. imports is the extent of the commercial market among domestic consumers. More than 10 per cent of all U. S. imports in recent years has been comprised of coffee, cocoa, tea, spices, bananas, etc., imported duty-free and completely lacking in direct domestic substitutes. Natural rubber is also admitted duty-free and, while its synthetic competitor was originally developed as a government enterprise, the industry now operates on a strictly commercial basis. The major restric-

* Numbers in brackets refer to publications listed in the bibliography given at the end of the essay.

tionist program in this area, that for sugar, has encompassed important advantages to foreign exporters, but its evolution affords a striking demonstration of how even a well-conceived commodity program can deteriorate in the course of time as the combined result of its own inherent logic and changing international circumstances.

In the depths of the depression, the traditional tariff proved an unsatisfactory protective arrangement. As the protective margin rose to some 400 per cent on an ad valorem basis, duty-free areas offshore (especially the Philippines) inadvertently enjoyed a strong incentive to expand output, to the competitive detriment of mainland producers and of Cuba, the major foreign supplier. A new sugar program, dating from 1934, relied upon four main features: (1) The total supply of sugar to the U. S. market was limited by government action; (2) statutory provisions prescribed how the domestic market was to be apportioned among the various producing areas, foreign and domestic; (3) the quota premium, the margin by which the domestic price was held above the equivalent world market figure, became the major element of domestic protection, although the tariff was not entirely abandoned; and (4) domestic growers also received a direct subsidy, paid out of funds ostensibly raised by an excise tax but in effect diverted from customs revenues.

While clearly a cartel arrangement that would have violated the antitrust laws if undertaken privately by the domestic sugar processors, the program was not without its compensating virtues. Improved labor standards in the sugar-beet fields, reasonable prices for domestic consumers, and promotion of international trade were objectives that received far more than lip service. Successive reductions in the tariff of 1930 permitted foreign countries to enjoy a large share of the quota premium on shipments to the U. S. market. Because Cuban sugar could be made available quickly to deficit areas on the Atlantic Coast, administration of the program was relatively simple and sugar prices within the United States could be stabilized within a narrow range. The locational advantages of Cuban supplies were especially important in overcoming the shortages associated with World War II and the Korean Conflict, at which times that island made sugar available without pressing her maximum bargaining advantage. Moreover, the explicit intent was to hold the subsidized industry to a "limited size."

That intent has been defeated by the program's own internal mechanisms. The price target has risen and the absolute margin of protection widened in the course of time, both at the refining stage and earlier in the production process, and despite real improvements in technological efficiency that could have been permitted to work in the opposite