BUDGETARY EFFECTS OF THE CAIRNS GATT PROPOSAL

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In July 1988, the Cairns Group submitted a proposal on agricultural trade liberalization for consideration at the upcoming Mid-Term Review of the General Agreement on Tariffs and Trade (GATT) negotiations.[1] The proposal includes both long-term goals and short-term measures. The long-term goals are consistent with the U.S. objective of complete liberalization of agricultural trade by a specified date, including removing barriers to the free flow of agricultural goods across borders and eliminating all production or consumption subsidies that affect agricultural trade. The short-term measures generally call for an immediate freeze on agricultural production and export subsidies and 10 percent reductions in the aggregate level of support for agriculture in both 1989 and 1990. The analysis provided here deals only with the short-term measures.

The Cairns group proposal does not specify the short-term policy changes that would be required of each country. The Australians have provided an "illustrative" example of types of policy changes that would conform to the Cairns proposal. Required policy changes in the Australian example include:

- <u>Export Subsidies</u>. Export subsidy payments would have to be reduced by at least 10 percent in each of 1989 and 1990.

- <u>Market Access</u>. Countries would have to ease quantitative import restrictions, or other measures such as the European Community's variable levies that restrict imports, to provide minimum access of 3 percent of domestic consumption. If current imports exceed this level, any restrictions on market access would have to be relaxed by 10 percent in each of 1989 and 1990.

- <u>Administered Prices</u>. Policy-affected prices, including target prices and nonrecourse loan rates in the United States, would have to be reduced by a minimum of 3 percent in each of 1989 and 1990. This would not apply to crops receiving relatively small levels of aggregate government support.

- <u>Supply and Acreage Controls</u>. Existing supply control programs could not be relaxed during 1989 and 1990 from current levels.

- <u>Stock Disposals and Accumulation</u>. Disciplines would be imposed to discourage additional government stock accumulation and to encourage orderly reductions of current stocks.

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1. The Cairns Group consists of Argentina, Australia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, Philippines, Thailand, and Uruguay. The Cairns group is made up mostly of exporting nations and represents a sort of "fourth force" in the GATT negotiations, along with the United States, the European Community, and Japan.

CBO reviewed the effects on U.S. agriculture and farm program spending of implementing program changes here and abroad that are consistent with these requirements. The analysis, which only covers the 1989 and 1990 crops, concludes that for the most part, program changes for the United States would be relatively small because current law is already moving in the direction favored by the Cairns group. U.S. producers of commodities that are exported--wheat, feed grains, and rice--would probably benefit marginally because program changes in other countries would increase the demand for U.S. crops. U.S. producers of commodities facing import competition--dairy and sugar--would experience marginally lower incomes because relaxing import quotas would pressure domestic prices.

Adopting the short-term measures would cause Commodity Credit Corporation (CCC) spending to drop for programs supporting crops that are exported. Reductions would result more from improved market prices, and hence lower deficiency payments, than from lower target prices. CCC spending for programs supporting sugar and dairy would rise. On net, the Cairns proposal would reduce CCC outlays from CBO baseline levels by an estimated $240 million in 1989, $300 million in 1990, and $485 million in 1991. The estimated outlay change in 1991 reflects 1989 and 1990 crop program cost changes; in this analysis program changes required by the Cairns proposal were not extended beyond the 1990 crops.

The Australian example does not fully specify needed program and policy changes. For the purpose of this analysis, therefore, CBO has assumed that 1987 would be used as the base year for determining required reductions in target prices, loan rates, and the milk price support level. Further, CBO assumed that minimum changes specified in the Australian illustration had to be made in each year--cumulative changes over the period would not suffice. Finally, it was assumed that the United States would not be required to revert to the relatively high levels of acreage reduction programs in place during 1987 and 1988.

Implications for U.S. Farm Programs

Adoption of the Cairns proposal would require changes to U.S. farm programs and trade policies. The changes, most of which would require legislative action, are not large over the two-year period being considered because current policy, particularly among the crop programs, is moving in a direction consistent with the Cairns-proposed requirements.

Administered prices. The Cairns proposal would require that U.S. target prices, loans rates, and price supports be dropped by 3 percent in 1989 and in 1990. In this analysis, 1987 is used as the base year--target prices, loan rates, and the milk price support level in 1989, therefore, must be at least 3 percent below 1987 levels and then be dropped by an additional 3 percent between 1989 and 1990.

There is some ambiguity in the description of the proposal about the appropriate base year. Also, it is not clear if a cumulative change of 6 percent by 1990 rather than separate 3 percent changes would suffice. On the first point, the choice of base year makes little difference except in the dairy program. For dairy, price support changes expected under current law meet the 3 percent minimum reduction when measured against a 1987 base, but not against a 1988 base. On the

second point, if cumulative percentage changes would satisfy the requirement of price reductions rather than changes in each period, then fewer program changes would be required.

The Cairns group proposal would require minimal target price reductions for wheat, corn and other feed grains, and rice. Nonrecourse loan rate reductions for those crops and sugar would be small as well. Table 1 shows changes required relative to current law. Corn target price reductions under current law are already sufficient to meet the minimum reduction requirement in both years, as are wheat and corn loan rates. Cotton, tobacco, and peanuts, all supported by U.S. programs, are not included in this analysis. No program changes would be required for soybeans because they get relatively little support from U.S. government programs. Dairy price supports are not shown because, as mentioned above, no change would be required under the assumptions used in this analysis.

The required target price change for wheat would be small--from $4.00 per bushel in 1990 under current law to $3.98 per bushel. For rice, the 1990 target price would fall from $10.71 per hundredweight (cwt) under current law to $10.48. No target price changes would be needed in 1989 to meet the Cairns requirements, and only these relatively small changes would be needed in 1990 because current law already requires target prices to fall.

Nonrecourse loan rates for wheat and corn projected in the CBO baseline already fall by more than 3 percent during each time period. A change would be needed in the 1990 loan rate for rice--a reduction from $6.50 per cwt to $6.30 per cwt--if the rice loan rate is considered an administered price. The importance of the rice loan rate as an administered price is reduced because there is a marketing loan program for rice. The marketing loan program allows producers to repay their nonrecourse loans at the loan rate or, if the world price is less than the loan rate, at the higher of 70 percent of the loan rate or the market price. Thus, the price floor that is defined by the rice loan rate (the minimum loan repayment rate) is $4.55 per cwt in 1989 and would be $4.41 in 1990 with a $6.30 per cwt loan rate. Current projections for the season average price in 1989 and 1990 are well above these levels, so the practical effect of changing the loan rate should be negligible.

The sugar loan rate is set by current law at $0.18 per pound through 1990. The support price would have to fall to $0.175 per pound in 1989 and $0.169 per pound in 1990 to conform to the Cairns proposal.

<u>Market access</u>. Provisions of the Cairns proposal would require that U.S. import quotas be relaxed. The annual quota on dairy product imports is now about 2.4 billion pounds when measured in milk equivalent units. Since dairy product imports currently are less than 3 percent of domestic consumption, the quota would have to be relaxed by the equivalent of about 1.8 billion pounds of milk to meet the minimum goal set for 1990 (see Table 1).

Sugar imports now exceed 3 percent of domestic consumption so the Cairns proposal would require the quota to be increased by at least 10 percent during each of 1989 and 1990. Quotas are currently set to support the domestic price at levels

TABLE 1. CHANGES IN U.S. FARM PROGRAM PARAMETERS REQUIRED BY THE CAIRNS GROUP PROPOSAL

	1989	1990
TARGET PRICES (By crop year)		
Wheat a/	0	-0.02
Corn a/	0	0
Rice b/	0	-0.23
LOAN RATES (By crop year)		
Wheat a/	0	0
Corn a/	0	0
Rice b/	0	-0.20
Sugar c/	-0.005	-0.011
DAIRY PRODUCT IMPORT QUOTA (Cumulative increase by calendar year, in billion pounds milk equivalent)	0.9	1.8
SUGAR IMPORT QUOTA (Cumulative increase by calendar year, in thousands of short tons)	0	100

SOURCE: Congressional Budget Office.

a. Dollars per bushel.
b. Dollars per hundredweight.
c. Dollars per pound.

high enough to avoid forfeiture of CCC nonrecourse loans made to domestic producers. The 1988 quota is 1.05 million short tons. The Cairns proposal would require annual 10 percent increases in the sugar quota. CBO assumes that the 1989 quota, which will be announced December 15, 1988, will already meet this minimum. However, as shown in Table 1, it is assumed that the 1990 quota would have to be increased by an estimated 100 thousand tons to conform to the Cairns proposal.

The U.S. beef industry is protected by import quotas, though in recent years voluntary restraint agreements with major exporters have kept imports below levels at which the quotas would be triggered. The aggregate support level for beef may not be great enough for it to be covered by the Cairns agreement. If it is covered, the Meat Import Law would be affected. The 1987 trigger level for import restrictions was 1,440 million pounds. Under the Cairns proposal the trigger level

that would impose the import quota would be increased to 1,584 million pounds in 1989 and 1,742 million pounds in 1990.

Export Subsidies. The Cairns group proposal calls for export subsidies to be reduced by 10 percent per year. The proposal would exempt export subsidies that have humanitarian objectives, such as food aid. Beyond this exemption, it is unclear how broadly export subsidy programs would be defined. The definition could be restricted to the export enhancement program (EEP) or could include the targeted export assistance program (TEA) and export credit subsidies. Analysis done by the U.S. Trade Representative assumed that only the EEP was covered by this requirement. The CBO baseline already contains sufficient reductions in EEP funding to satisfy the Cairns requirement if 1987 is used as the base year.

Production Controls. The Cairns group proposal would also require that production controls not be relaxed from levels in force at the time of the Mid-Term Review. For this analysis, acreage reduction programs (ARPs) were not changed from levels already assumed in the CBO baseline for the 1989 and 1990 crop years, so this element of the proposal does not enter this analysis.

If an earlier base period were used and the United States was required to use ARPs in place for the 1988 or 1987 crop years during 1989 and 1990, planted acreage of wheat and feed grains would be significantly lower than assumed in the CBO baseline. For these crops, 1987 and 1988 acreage reduction requirements were set at very high levels to allow the large government-owned and -controlled stockpiles of grain to be reduced. The 1988 drought is causing stocks to fall to more normal levels. Returning to previous acreage reduction programs with current stock levels would cause domestic and world commodity prices to increase substantially, would place the United States once again in the position of supporting world market prices and being the residual supplier, and would permit competitors to capture most of the benefits of the expansion of trade that should result from trade liberalization.

Stock Accumulations and Disposals. Finally, the Cairns proposal would limit government stock changes. Constraints on stock disposals are not expected to affect the operations of U.S. programs because U.S. government-owned stocks will be at relatively low levels at the end of this marketing year. Relaxation of the sugar import quota could cause the CCC to acquire some domestically produced sugar without further policy changes.

Implications for Commodity Markets and CCC Outlays

Table 1 indicates that with few exceptions U.S. commodity programs would be affected minimally by the implementation of the short-term elements of the Cairns proposal. For crops that the U.S. exports--wheat, corn, and rice--the major effects of the Cairns initiative on producers, and on CCC outlays, would be from changes in international trade. The implicit assumption used in this analysis is that the Cairns proposal would be implemented fully by all members of the GATT. Expansion of trade in response to the Cairns proposal could affect demand for supported commodities directly and via changes in demand for meat products using these commodities as inputs.

For dairy, the major effect of the proposal would be from relaxing import restraints on dairy products. For sugar, adopting the proposal would cause higher imports as well as lower prices. Following are discussions about the projected effects of the Cairns proposal on U.S. commodity markets and CCC spending for major crop programs.

Wheat. Under the Cairns proposal, CBO expects that world and U.S. wheat prices would rise relative to levels assumed in the CBO baseline. The European Community (EC) would be expected to reduce domestic supports and export subsidies and Japan would be required to allow greater imports. Thus, market access for U.S. wheat would improve and export demand would increase, particularly in Japan, and, for high quality wheat, in the EC.

U.S. (and world) prices are estimated to rise above baseline levels by about $0.10 per bushel during 1989 and 1990 because of the demand increase. U.S. production would respond very little to the price rise because acreage reduction programs are assumed to be unchanged from baseline levels. The small change in the wheat target price called for in the proposal (a drop of 2 cents per bushel in 1990) would do little to affect the incentive to participate in acreage reduction programs. However, a somewhat higher expected market price would encourage production outside the government program and, consequently, U.S. production would tend to rise slightly.

U.S. wheat farmers would benefit from higher market prices but most of the gains in market receipts would be offset by declines in government deficiency payments. CCC wheat program outlays are estimated to fall by $130 million in fiscal 1989, $260 million in 1990, and $150 million in 1991 (see Table 2). The bulk of the drop in outlays would result from lower deficiency payments caused by higher market prices rather than from the relatively small decline in the target price.

Feed Grains. Under the Cairns proposal, export demand for U.S. corn and other feed grains would be expected to increase. U.S. meat exports would also be expected to rise, causing an increase in domestic feed demand.

Specific changes that might be expected with adoption of the Cairns initiative would be expanded exports of feed grains (both as raw products and in the form of meat) to the EC and Japan. In addition, the reduction in EC export subsidies would be expected to reduce competition from feed grain substitutes such as low quality wheat from the EC. Given the modest nature of the changes contained in the short-term portions of the Cairns proposal, world trade in coarse grains should expand only slightly. The United States would probably capture the majority of this expansion, with annual exports increasing by between 40 million and 60 million bushels. Prices might increase by 5 cents per bushel as a result of this export expansion. As a result of these effects, CCC feed grain program outlays would be expected to fall by $160 million in fiscal 1989, $130 million in 1990, and $300 million in 1991.

As in wheat, market receipts of U.S. feed grains producers would be expected to rise, but much of the gain would be offset by reductions in deficiency payments. Higher grain prices would also mean higher input costs for livestock producers. The

TABLE 2. ESTIMATED CHANGES IN COMMODITY CREDIT CORPORATION OUTLAYS RESULTING FROM ADOPTION OF CAIRNS GROUP PROPOSAL (By fiscal year in millions of dollars)

	1989	1990	1991
Wheat	-130	-260	-150
Corn and other Feed Grains	-160	-130	-300
Rice	-30	-85	-85
Dairy	80	155	45
Sugar	0	20	5
Total Outlays	-240	-300	-485

SOURCE: Congressional Budget Office

net effect of the Cairns proposal on livestock producers' incomes would depend on the extent of increases in export demand for U.S. livestock products.

Soybeans. The Cairns proposal would have few direct effects on soybeans because few restrictions currently limit soybean trade. However, soybeans compete with wheat, corn, and other feed grains as animal feeds, and changes in prices and trade flows of these commodities will affect soybean demand. Specifically, reductions in the EC variable levy would tend to increase EC grain imports at the expense of soybean and soybean meal imports. Also, to the extent that the U.S. meat exports increase from greater access to foreign markets, domestic demand for soybeans could increase. Overall, U.S. market prices probably would fall with adoption of the Cairns proposal, but they are expected to remain above CCC nonrecourse loan rates, so no changes in CCC outlays for soybean price support would be expected.

Rice. The short-term provisions of the Cairns proposal should expand world trade in rice primarily because the Japanese market would be gradually opened up to imports. U.S. production is expected to remain close to baseline levels in 1989 but could fall slightly in 1990 because of the target price drop. The trade expansion would result in somewhat higher prices than now projected in the CBO baseline. World prices might increase by $0.35 to $0.50 per cwt as a result of the higher export demand. Because of these price increases, and the $0.23 per cwt drop in the 1990 crop target price, CCC rice program outlays would be expected to fall by $30 million in 1989, $85 million in 1990, and $85 million in 1991.

As with other supported crops, producers' gains in market receipts from higher rice prices would be largely offset by lower deficiency payments. Declines in deficiency payments caused by the 1990 target price drop would further reduce net incomes of rice producers.

Sugar. With full-scale trade liberalization, U.S. sugar producers might be major losers. For the smaller changes envisaged by the Cairns short-term measures, sugar producers would not be affected greatly. Domestic use of sugar has expanded strongly in the past year, up 2.5 percent, and should continue to increase over the near term as demand for corn sweeteners levels off. Increases in domestic demand would reduce the effects on U.S. producers of the Cairns proposal's requirement that the import quota be relaxed.

In 1988, sugar imported under the quota will be approximately 1.06 million tons, or nearly 13 percent of domestic consumption. Under the Cairns proposal this would have to increase by at least 10 percent in 1989 and again in 1990. The expected loosening of the 1989 quota would meet the minimum increase required, resulting in no change from current law. And, even though nonrecourse loan rates would be required to fall from baseline levels under the Cairns proposal, market prices would not be expected to change.

In 1990, the Cairns proposal would require a quota increase above baseline levels, resulting in additional imports of an estimated 100 thousand tons. The resulting increased supplies would tend to reduce prices. Some nonrecourse loan forfeitures would be expected, even though nonrecourse loan rates would be about one cent per pound less than under current law during 1990. The forfeitures would increase outlays by an estimated $20 million in 1990 and $5 million in 1991 and would violate the no-net-cost feature of the sugar program in current law.

Dairy. In the CBO analysis, the Cairns proposal would affect the U.S. dairy industry and CCC dairy program outlays only through requiring increases in the dairy product import quota. Dairy price support levels assumed in the CBO baseline already decline enough over the period to meet the Cairns requirements.

Increasing the import quota would pressure U.S. milk and milk product prices and, with market conditions assumed in the CBO baseline, would cause government acquisitions of dairy products to rise by nearly as much as imports increase. Greater acquisitions raise outlays above baseline levels by an estimated $80 million in fiscal year 1989, $155 million in 1990, and $45 million in 1991. The fiscal year 1991 cost would result from the calendar year 1991 import quota exceeding baseline levels and would be greater if the import quota expansion were extended beyond 1990.

Dairy farmers would face slightly lower milk prices with the increased import competition. The decline in dairy producers' receipts would have been more pronounced if the increases in government milk purchases in the price support program had triggered a milk price support decline. Under CBO baseline assumptions, a price support decline would occur even without the import increase.

Implications of More Complete Trade Liberalization

The short-term measures of the Cairns proposal discussed above are first steps toward more complete liberalization of agricultural trade. Estimates from a number of studies provide indications of the effects of complete liberalization on U.S. and world agriculture. Some studies have focused on the agricultural sector, while others have examined broader national economic ramifications of trade liberalization.

Unilateral as well as multilateral liberalizing policy changes have been analyzed. Some of the models have been static in nature (focusing on the endpoint of negotiations), others have been dynamic (examining the adjustment path as well as the endpoint).

Although the analyses of full trade liberalization differ in many ways, a general pattern of results does emerge. Some of these general results are:

- World market prices for most commodities would increase.
- The volume of trade in agricultural commodities would increase.
- Significant distributional effects of agricultural trade liberalization would occur as consumers and taxpayers gain in aggregate and agricultural producers lose in aggregate.
- The net economic effects of agricultural liberalization are positive but relatively small.
- Within agriculture, landowners and producers of crops with the greatest amount of protection are likely to be the most negatively affected by liberalization. Beginning farmers may benefit from lower land prices and rental rates.

All of the studies of agricultural trade liberalization were done before the 1988 drought. Many were done before the 1985 Food Security Act took effect. The political and economic environment facing the current agricultural trade negotiations, therefore, has changed significantly since many of these trade liberalization analyses were completed. For example, the drought has driven up prices of many commodities, reducing the budgetary costs of commodity programs around the world and correspondingly reducing some of the budgetary pressure for trade reform. The 1985 Food Security Act has reduced the role of the United States as residual supplier and has lowered or eliminated the price floor for many commodities. For the United States, the commodity programs would have become less expensive even without the drought because target prices are now on a downward trajectory and world prices exceed nonrecourse loan rates for most supported crops.

Adoption of the Cairns group proposal would have effects different from those suggested by the studies of full trade liberalization because it is a relatively small movement toward liberalization and because it would involve specific policy changes at a specific time--current conditions and the effects of being in a transitional period might influence its effects. General results of the full trade liberalization studies were used only as guides in this analysis.