Viewpoint

Historical perspectives—and the future

Dwayne O. Andreas, chairman of the board and chief executive for Archer Daniels Midland Company, spoke on "Historical Perspectives on Development of the World Oilseeds Industry and Prospects for the Future" at the International Association of Seed Crushers meeting during May in Rome. Andreas urged crushers to become politically active to promote free market economic policies for oilseeds lest contrary government policies create economic disequilibrium in the industry worldwide.

It has been 30 years since I spoke to this important annual forum of the oilseed processing industry's global leaders.

Much has happened since then, but my message today remains what it was back in 1955: "United States crushers would be willing to let the economics of a free market determine when and where oilseeds should be crushed."

Even then—when we were at the start of what now looks like the Golden Age of our industry—there were instances of marketplace interference by governments.

My free market message was well received in 1955, and I hope it will be well received in 1985. This association has demonstrated its abiding faith in a free world trading system. Two years ago the "President's Group" of the IASC unanimously affirmed its belief that "only a free market philosphy would . . . best serve the necessities of the world in oils and fats and protein supplies." Global fats and oils commodities agreements have been shunned. Our experience confirms that free markets are the most efficient means to allocate resources, to determine where crushing and refining capacity is built, to source raw materials and processed products.

But these days, it sometimes seems we've lost the struggle for free markets to a new mercantilism that threatens our industry and the food needs of the world's people.

The years between 1955 and 1980 saw an unprecedented, sustained growth in production and processing, in world consumption of foods and in living standards and diets.

However, by 1980, government interventions repealed the law of comparative advantage. A rational system of production and marketing has become an irrational web of unfair trade practices sponsored by government. Dynamic growth has turned to recession for our industry. Demand for oilseed products has slowed, and substantial overcapacity plagues our industry worldwide.

What happened?

Why did we go from boom to bust?

Conventional answers include the rising dollar, the world debt crisis and the economic contraction of the early 1980s. I believe these conventional answers are not the full explanation. The real answer lies in government actions that disrupted the global marketplace. Economic rationality lost out to policies based on domestic political expediency.

Everyone has been hurt: Governments, whose budgets are swollen by uneconomic subsidies; producers and processors, who are battered by unfair trading practices, and consumers, who are denied the benefits of access to products of world market foodstuffs based on comparative advantage.

The experience of the American soybean industry illustrates what happened when the free world market for soybean products was destroyed. Our industry is one of the few agricultural sectors that lives under a market-oriented domestic agricultural policy. The soybean crop has been protected only by price support loans whose levels are set at below market clearing levels.

There are no allotments, no target prices, no deficiency payments and no set-asides. As a result, the soybean program has imposed minimal costs on the U.S. Treasury. Our government rarely has had to acquire soybean stocks.

Many people in Washington want to make the market-oriented soybean program the model for all commodity programs in the 1985 Farm Bill. That is ironic, because the industry also can serve as a model of suicidal devotion to free market principles in a world dominated by mercantilistic trade policies. Subsidized exports of competing edible oils and oilmeals are squeezing us out of our markets. We are caught in a constant bidding war in which other exporting nations unfairly "buy the business" of importing nations. As a result, exports of U.S. soybeans, soybean meal and soybean oil are lower today than they were in 1977.

We in the U.S. industry have tried to access the problem of export subsidies through remedies provided by U.S. trade laws and GATT. Our National Soybean Processors Association filed a Section 301 petition with the U.S. Trade Representatives over two years ago. Our goal was to restore free trade competitive conditions to an interdependent world oilseed economy. But our government disassembled the NSPA petition into separate country components, largely defeating its global purpose.

Although there have been some positive steps, such as Brazil's suspension of its preferential export financing programs, we are still trapped in a world marketplace distorted by a matrix of subsidies and export incentives.

The problems of the U.S. soybean industry are not unique. The markets for virtually all agricultural commodities have been twisted out of shape by government actions.

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I must admit that my own government has contributed to the damage done to the free world markets.

U.S. agricultural policy protects many basic commodities through an elaborate system of price supports. Such devices, when used to provide for orderly, stabilized markets, can be helpful. But they are harmful when they are used to remove huge stocks from the market and disrupt the normal market price functions. And what harm they have done in recent years! The 1981 Farm Bill set price support parameters for wheat, cotton, corn and rice that helped price the U.S. out of world markets. Forty percent of U.S. production is accounted for by exports. But this year exports will drop to only $33.5 billion—some $10 billion lower than they were in 1981.

The cost to the U.S. Treasury has been enormous, but the cost to a depressed farm sector has been even greater. American producers have become residual suppliers to markets they once dominated.

The U.S. also has subverted its hard-won reputation as a reliable supplier of agricultural commodities through ill-advised embargoes. In 1973, the U.S. restricted exports of soybeans and soybean products because of expected supply shortages. The embargo hurt Japan. Predictably, the Japanese responded by investing heavily in alternative sources of supply. When America's soybean production came back on the world market, it faced new and tougher competition.

In 1980, for political reasons, President Carter imposed an embargo on agricultural sales to the Soviet Union. Again, the result was predictable. Soviets replaced American commodities with those of other nations. The U.S. embargo program turned out to be really a suicide mission. Our industry's progress in developing the Soviet market for soybeans and other products was wiped out overnight and is still zero. President Reagan wisely lifted that unfortunate embargo. But the 1982 embargo on pipeline equipment raised new doubts about the reliability of the U.S. as a supplier.

And this month's embargo on all trade with Nicaragua can only inflict further damage on our reputation as a dependable trading partner. We are sorry about these things. Such misguided policies have dealt a heavy blow to the goal of free world markets. And their prime victims have been U.S. producers and processors.

Now, having been critical of my own country's policies, I trust you will indulge me in the right to criticize the other nations' policies.

Brazil should serve as a lesson to nations that still cling to policies that violate free market principles.

Brazil misallocated her economic resources and disrupted the world market for soybean products through massive export subsidies. These subsidies led to irrational investments in crushing capacity. And I'd like to point out that these subsidies were paid for almost entirely with borrowed money—which reminds me of something my father told me when I was in the fourth grade. He said, "Son, (I always thought he called me son because he couldn't remember my name) if you're ever going to be in business, you have to know about compound interest. To find out how long it takes to double your savings, divide an interest rate into 72 or divide 72 by the interest rate. Example: If you're paying 12% interest and you divide 12 into 72, it is 6. That means that you double your money in 6 years, with compounded 12% interest. If your interest rate were 6%, you divide that into 72, and you double your money in 12 years, and so forth." Well, I found all through these 60 some odd years that that formula is correct. And that it is indeed important to know about compound interest so that you know that if you have a $14 a ton export subsidy on soybean meal paid for with money borrowed at 12%, the cost of that subsidy at the end of 6 years is $28 a ton. And it is $56 a ton after 12 years. So subsidies and their aftermath have become a tremendous burden for the government of Brazil to carry.

As a result of lavish subsidies which in some years exceeded the entire cost of processing, Brazil, a nation whose soybean crop averages about 15 million metric tons (MT), has built a soybean crushing capacity of 25 million MT. It should come as no surprise that Brazil's industry is now undergoing a painful contraction.

Argentina's differential export tax system achieves the same result: keeps soybeans off the world market and artificially lowers the cost to Argentine crushers by an amount equal to the entire cost of processing. That powerful subsidy enables Argentine exporters to undercut world market prices for meal and oil. Strangely enough, the crushers do not put the subsidy in their pockets, but they put it largely into the pockets of their customers, costing the rest of us hundreds of millions of dollars. Over three million new tons of crushing capacity is being built in Argentina. When the pain comes, as it most certainly will—as it is coming to Brazil—the Argentine crushers will be able to say with no satisfaction, "We got it the old-fashioned way. We earned it."

But these beggar-thy-neighbor policies are rampant elsewhere in the world.

Spain has a domestic consumption quota on soybean oil and a variety of export incentives. It channels almost all of its soybean oil production into third-country markets at the expense of taxpayers. Those unfair practices have displaced U.S. and E.C. soybean oils from Northern Africa and the Middle East at great expense to the Spanish treasury.

Malaysia's preferential duty exemptions have stimulated construction of a vast excess of palm oil refining capacity, now becoming high-cost and inefficient. The result—depressed export prices for refined palm oil products and reduced prices and margins for edible oil products worldwide.

And the worst may be yet to come.

The EEC discusses a consumption tax on vegetable oils. Once government determines the price of cooking oil and margarine through consumption taxes, it replaces market forces with politics. In the European context, that means delivering the consumer and the fate of our industry to the powerful dairy and olive oil interests. Under such circumstances, seed oils and margarine oils could be doomed. We are altogether too complacent about the plans for that vegetable oil tax in the EEC. I want to remind you again of something that we all know. We cannot count on governments to be rational. Don't count on it.

I want to give you two examples. Take sugar: I was there in 1960 when the programs were set up ostensibly to become self-sufficient in food on the continent. So it is that the EEC pays 27¢ a pound for sugar which is not needed. As a result, production has risen by six million tons, far above requirements. The surplus has been dumped on the world market—shoveling it onto the world market, selling it, dumping it, like a pile driver, driving the market down, down mercilessly under one of the most grotesque economic policies in world history. Ruining, wrecking, the economies of third-world countries. Smashing the hopes of their former suppliers and colonies. Creating poverty all over the third world. The U.S. and others have had to go to the rescue with foreign aid programs and military programs, and maybe a little war here and there. A massive, destructive economic program administered by the EEC. It is convenient to blame the Communists, but the EEC dumping policy, driving sugar prices from 18¢ a pound down to 3¢, is the culprit. An economic study estimates that the EEC sugar dumping policy has reduced third world income by $6 billion a year!

Now I was there in 1960, and if I had told any of those commissioners that they would be buying sugar for 27¢ a pound and selling it for 2.7¢, less than one-fifth of the cost of production anywhere in the world, they would have thrown a net over me. They had no intention to do that. And in 1970, they had no idea that they were going to do that. And in 1975, they had no concept of what the result would be. Nevertheless, it goes on and on and on. To my knowledge, the U.S. sugar program was a direct result of the need to defend free enterprise against the EEC dumping, and to give third world suppliers a share of the American market at a fair price.

Now we see it in butter. How do you like butter being bought at more than one dollar a pound, and being sold to our customers at 21¢, wrecking markets for vegetable oils? Was this ever intended? No. These things are born out of fear. Fear of the dairy lobby, fear of the beet sugar lobby.

Never assume that a government will act rationally!

I give you these two examples because I want to remind you that, if you sit idly by and let a tax go on our principal product, vegetable oil, you're likely to see the dark ages for the oilseed crushing industry for many decades. It did not take very long for government intervention to destroy a quarter century of progress in world agricultural markets. It will take a lot longer to recover from the negative results of government manipulation of markets.

But we must begin, and we must begin soon. I sense a gathering of support for a return to free market principles. Many producers and processors who sought government help are having second thoughts. Others, including many in the EEC, want to escape a future of escalating subsidies and trade wars.

I have long felt that change will not occur unless the U.S. government fights back against practices that have twisted world markets out of all recognizable shape. I think it was Sir Isaac Newton who once said, "For every action, there is an equal and opposite reaction." The U.S. has announced that it will offer commodity bonuses to buyers of its agricultural exports, and that is a major step in that direction. The export bonuses will apply to nations where the U.S. has been victimized by unfair trade practices. Compared to subsidies offered by others, including the EEC, this new plan is very modest. But I think it involves about $2 billion of export subsidies to be provided over the next three years. It announces to the world that the U.S. will no longer turn the other cheek. It signals that it will not allow its farmers to be driven to the wall by predatory trade practices in some cases financed by national treasuries—I should say financed by loans to foreign treasuries from U.S. banks.

The U.S. action is being interpreted as a declaration of economic war. Well, I can tell you that it is not. Rather it is an appeal to reason, a move to encourage the protectionists to negotiate the restoration of free market principles.

Perhaps that kind of shock treatment is necessary. For the closer we come to the brink of an open trade war, the more incentive there will be to pull back and negotiate mutually beneficial arrangements. Personally, I advocate continuous consultation among EEC economists, those from Argentina, Brazil, Japan, the U.S. and third world countries.

Certainly the world oilseeds economy and other commodities desperately need a multi-national climate to eliminate the practices that sap its strength.

I want to remind you—a whale is a mammal that learned to live in the sea. Although we are merchants, we must become politically active. We are merchants, but now we have mercantile states, competing with one another, going into business, in some cases driving free enterprise out of business. To become politically active, we have to become allies. We need to have the seed growers understand the problem. They have political strength in numbers. We need to have our labor unions understand our problems. We need farmer-laborer coalitions with processors. In order to enlarge our political strength, we need the help of these people. Remember, politicians respond primarily to fear—fear of the dairy lobby, fear of sugar growers. Waiting for the mercantile states to change their policies is like holding on the landing lights for Amelia Earhart. It isn't likely to happen.

We're just getting to the stage where negotiating forum and negotiations among all of our countries might become possible, but it will be difficult. It requires rethinking the domestic agricultural policies of our respective countries. We will have to develop an international industry-government consensus on the problems and what needs to be done to solve them.

The membership of this organization is well-placed to help inaugurate that multi-national negotiating process. You have a record of support for free trade policies. You have been severely damaged by unfair trade policies. You have an abiding interest in a growing oilseed economy to supply the world's need for oils and meals. You can encourage more rational thinking and more reasonable policies.

I am hopeful that each of us will leave Rome determined to meet the challenge that faces our industry. That each of us will redouble our efforts to restore sanity to an irrational trading system. That each of us will work to convince our governments that only fair practices in a free marketplace can serve the needs of the world's people.

Socrates, hundreds of years ago, said, "No man is fit to govern unless he understands the politics of wheat." So I suggest to you this is not a new problem, it is a recurring problem. Our industry should be geared up to deal with the political realities of a mercantile world.

Shakespeare once wrote:
"There is a tide in the affairs of men,
That tide, taken at the flood, leads on to fortune;
But when the tide is omitted, all the voyage of their life
Is bound in shallows and miseries.
On such a full sea are we now afloat;
And we must take the current when it serves.
Or lose our ventures."

Viewpoint

More U.S. export subsidies

By David Bartholomew, Senior Soybean Specialist
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(David M. Bartholomew, oilseeds specialist for Merrill Lynch Futures Inc. at the Chicago Board of Trade, is a regular contributor to JAOCS' Viewpoint. In this article, Bartholomew outlines the new government policy for reducing surplus crops by using them to subsidize exports. The results may be more long-lasting and more expensive than now anticipated, Bartholomew warns.)

USDA has devised a plan to liquidate surplus commodities that are costly to store. It's a political trade-off with Congress in their deliberations on the government budget affair. It is called BICEP (Bonus Incentive Commodity Export Program) and should not be confused with PIK because it is not necessarily "payment-in-kind." The transaction may include anything in CCC storage, such as dairy products, grains or cotton, even though purchasing something such as grains or oilseeds or products. In the final analysis this means the purchased commodity will cost less than in a normal transaction. Thus it is a subsidized sale and has to be considered bearish.

The government has been trying to find a way to get U.S. prices down to world levels which are below support levels without actually dropping those guarantees. Surely this is a way to do it. By opening government bins that prevously had been sealed under price formulas, there all of a sudden is more free supply than there was before.

Other exporting countries view this as a threat, and they have started to reduce their prices. Certain U.S. officials had been seeking a way to gain more leverage in trade negotiations, and this should do it. They had been trying to persuade other countries to reduce or eliminate their export subsidies, and this could do it. Rather than acquiesce, however, they probably will retaliate by erecting high tariff barriers against U.S. goods, and a full scale trade war will be on.

The program also can be far more expensive for the U.S. government than it currently calculates. There is much more involved than just the quantities currently in CCC storage. Prices are not likely to move high enough for farmers to redeem commodities still under loan under 1984 and previous crops, so those will be forfeited to CCC ownership. Moreover, prices are likely to stay so low in the year ahead that most of the commodities eligible to go into the 1985 loan program will do so, and ultimately they too will be forfeited to CCC. The same could be true in 1986 and maybe beyond.

We've been through such a scenario before. There is a remarkable similarity to the early 1930s period. Only some of the operational details are slightly different. The trouble is, no one under 70 years was an adult at that time and no one seems interested in studying lessons learned at that time.

Now, as then, economic conditions are not strong enough to create demand equal to supply. Now, as then, USDA thinks low prices will indulge acreage reductions sufficient to match demand. It doesn't work. Now, as then, it will take a serious drought to bring down supply and firm up prices. That could happen this year, as has been pointed out previously. Right now nearly all the growing area of the U.S. is in good to excellent condition, though late May and early June were drier than normal in some major areas.

The BICEP program must be considered an important event. It is more than just a passing fantasy. U.S. politicians are desperate to reduce costs and to try to show the farmers they are doing something to work off surplus crops. Congress is providing a huge budget ($2 billion) to operate the program and demanding it be spent. The problem is that prices are likely to go down more than they realize and for a longer period of time than they think, and costs to the taxpayer will be more than they expect. Again, that's the way it was in the early 1930s even though USDA kept painting a bright outlook.

How low can soybean prices go? Previously it was safe to predict that the loan level formed a floor. This would be equivalent to about $5.25 to $5.40 July futures. That may no longer be true. Certainly wheat and corn can go below their loan equivalents if USDA inventory is no longer isolated from the market. South American soybeans have a questionably effective floor. Brazil's support price is $4 a bushel at present official exchange rates. So those beans could be merchandised profitably, even after costs, at any price to $3.62 per bushel, which certainly is no help in sustaining values anywhere near to present trading levels.

Next the question is: Will U.S. farmers sell enough to supply consumptive demand if prices move lower? Probably not, but for awhile the U.S. can survive anyway. Already soybean oil has been imported. Can other oils be far behind? Soybeans also could follow. Such action would, of course, bring up international values from their new lows that may be established first, but probably not before the U.S. Congress erects import barriers higher than at present and a full-scale trade war develops.