

From Washington

in the Jan. 1, 1987, *The New England Journal of Medicine*, low-fat diets did not prevent breast cancer. Willett reported that women who consumed 44% of calories from fat had an 18% lower risk of breast cancer than those who

averaged 32% of calories from fat. Details: *Food Chemical News*, Jan. 5, 1987, p. 2.

In the Dec. 25, 1986, issue of *The New England Journal of Medicine*, results of two studies linked high serum cholesterol levels with

cancers of the colon and rectum. The studies were conducted by researchers at the Karolinska Hospital in Stockholm, Sweden, and by University of Munich researchers in West Germany. Details: *Food Chemical News*, Jan. 5, 1987, p. 19.

Viewpoint

Industry at the crossroads

The following remarks were made by Donald E. deKieffer before the International Association of Seed Crushers (IASC) meeting in New Delhi, India, in November. DeKieffer, currently a partner in the firm of Pillsbury, Madison & Sutro, based in Washington, D.C., is engaged in the practice of international trade law and policy. Between 1981 and 1983, he served as general counsel to the U.S. Trade Representative, Executive Office of the President.

Introduction

For at least 150 years, economists have postulated the theory of "comparative advantage"—that it is economically advantageous for all countries to produce those things in which they are most efficient and to import those products which other countries can produce more cheaply or efficiently. Thus, "comparative advantage" suggests that countries such as Thailand, with flat land, warm climate, plenty of water and cheap labor, should produce rice, while countries endowed with iron ore and coal should make steel.

Even today, economics students are taught this theory as if it were a law. Nothing could be further from the truth. "Comparative advantage" did not operate when the theory was propounded and does not today. Even 150 years ago, transportation costs, financial expenses, subjective demands which were not cost-driven and nascent political imperatives "skewed" the comparative advantage "model" into something quite different than the theoretical form.

Today, there are increasingly complicated political and economic factors at work. The world economic system has yet to adjust to the collapse of imperialism and the emergence of Third World coun-

tries as independent political forces. While a small group of European nations no longer dictates where products will be produced and sold to maximize "comparative advantages," their economic interests and domestic political imperatives favor maintenance of the old economic order. The newly emerging nations have become painfully aware that exclusive reliance on a single product or commodity is dangerous. Countries with but one "cash crop," be it bananas, bauxite or petroleum, are vulnerable to collapse in prices and to political or economic whim. Therefore, most countries, particularly traditional "producers" of raw commodities, have attempted to repeal or at least amend the "law" of comparative advantage by diversifying. To do so is neither painless nor inexpensive.

Developing countries have adopted various plans to encourage the creation of new industrial and agricultural sectors, usually by some direct or indirect subsidization. To preserve their traditional "sectors," developed countries have responded with massive price supports and a sophisticated array of protectionist devices to thwart the diversification policies of their trading partners.

Developed countries also have adopted social policies having little

to do with the economics of production. Social policies favoring traditional "family farms" have been cited as an example. To offset the artificial disadvantage of such social policies, First World countries increasingly have turned to more Draconian subsidy and protectionist practices to retain many sectors of their economies. This has led not only to huge tax bills at home, but has prevented countries with more efficient production from entering potentially lucrative markets.

Today, there is hardly an industrial sector in the world not affected more by government policy than by the pristine model of "comparative advantage." While the costs of protectionism and subsidization are not totally calculable, they far exceed the real costs of production and distribution in a "comparatively advantageous" world.

Since World War II, developed countries (and, increasingly, the developing countries as well) have sought to slow the growth of



government intervention in the marketplace. These efforts have focused primarily on two vehicles: cartelization and deregulation.

Cartelization

In an attempt to regulate price and supply, cartels have been established in the past half-century for such diverse products as tin, coffee, sugar and petroleum. While most such cartels have been centered on commodities, there is a trend toward applying these principles to manufactured products such as steel and textiles.

The cartels' success has been limited due to the willingness of some members to cheat on their commitments. Cartels rely upon rigorous discipline by all producers as the *sine qua non* for their success.

Further, consumers have rebelled against such restraints either by choosing alternative products or by refusing to purchase altogether. Nevertheless, price/supply cartels have been partially successful in certain geographically concentrated products—giving impetus to other industries as an alternative to the uncertainties of the free market.

Deregulation

At the other extreme are those, mostly from developed countries, who advocate "fair competition" and a "level playing field." But to draw much from this fact would be an error. Most Western democracies believe the free market theory necessitates a "freedom to fail." This attitude is not widely held or politically viable in developing or newly industrialized countries attempting to diversify their industrial and agricultural sectors, for whom failure of a major development project is intolerable.

Western democracies do not totally embrace the "freedom to fail" theory. But they are sufficiently diversified to absorb some losses, while those in the developing world are not. Many Western governments' stake in social programs is so immense that their abandonment would destroy the social system the governments themselves have built.

Oilseeds are a striking example of a global industry at the cross-

roads. Rapidly growing for the past 20 years, this industry now faces the prospect of increasing regulation, either by individual governments or by joint action to control prices and production. It is neither a cartel nor an example of free trade. Choices must be made within the next few years, or a third alternative—economic anarchy—is certain.

The problem

A number of factors coalesced in the 1980s to result in a world agricultural commodity surplus in general and in the oversupply of oilseeds and oilseed products in particular. These factors included:

- unexpectedly high yields from improved plant varieties and farm techniques;
- "double cropping" of oilseeds such as soybeans, creating more supply without additional acreage;
- large acreage increases in many countries, including the United States, Brazil, Argentina and Malaysia;
- a leveling of demand growth below predicted levels for proteins and edible oils.

These factors provided substantial supply pressures in the market which would have been ameliorated by natural economic compensations (lower prices and profits and a concomitant decline in production and processing investments) except for market intervention and subsidy programs developed by various governments, which have continued the upward movement in supply. The result: a continued downward spiral in oilseed and oilseed product prices. Orderly marketing of oilseeds and oilseed products is dangerously threatened by artificial barriers and destructive subsidies. All countries must begin to take steps to eliminate those practices and get back to the market.

Problematic government interventions:

European Economic Community

The EEC is a major market for unprocessed oilseeds and for protein meal to supply its pork and

poultry industries. While the EEC is a major net importer of edible oils such as palm and coconut, it also has become a major net exporter of edible oils such as soybean and rapeseed.

•*EEC policy on rapeseed*—The EEC provides a subsidy to offset a part of the cost to EEC oilseed crushers of purchasing EEC-grown rapeseed. EEC rapeseed production is uneconomic, and without this subsidy, little would be grown. While the subsidy is intended to provide income support to EEC rapeseed farmers, it also creates a substantial supply of rapeseed oil for which there is no EEC demand (in part, because of other EEC policies to foster its dairy and olive oil industries). The net result: the EEC exports about 500,000 metric tons (MT) of subsidized rapeseed oil that competes in world markets with soybean and rapeseed oil from other sources.

•*Spain's domestic consumption quota*—Spain intervenes in the market to protect its olive oil producers. Spain is a major importer of unprocessed soybeans, with a large processing industry to meet its large need for protein feed. However, Spain limits domestic soybean oil consumption to 90,000 MT, forcing more than 300,000 MT of Spanish soybean oil into export at low prices.

•*Spain's export subsidies*—Before joining the EEC, Spain granted its oilseed processors a subsidy in the form of a rebate on its turnover tax, equal to 7% of the FOB (freight on board) value of all soybean oil exported. Soybean oil did not, in fact, bear the rebated tax. This enabled Spanish crushers to reduce the prices of soybean oil channeled into export by the consumption quota. Forced to abandon its tax rebate practices under terms of the EEC accession agreements, Spain has convinced the EEC to formulate a regulation permitting a direct subsidy to producers equal to 22.8 ECUS per MT of exported soybean oil.

•*Portugal's domestic consumption quota*—Prior to accession, Portugal limited access to its markets through a state-run trading organization (IAPO). Although Portugal largely dismantled IAPO

prior to its EEC accession, the EEC has implemented a soybean oil consumption quota system similar to that used by Spain.

•*European import barriers*—Europe limits access of foreign-source vegetable oils to its domestic markets by imposing a 10% import duty on crude edible oils. Brazil and Argentina have cited this as a justification for their own subsidy practices. In the summer of 1986, the EEC threatened to curb bound duty-free U.S. imports of soybeans, corn gluten and other animal feeds, an action strongly resisted by the U.S. government and U.S. farm interests.

The United States

U.S. agricultural and trade policies have focused primarily on protecting the traditional farm production base. Many major crop support and subsidy programs that assist a large segment of U.S. agricultural production have not been extended to oilseeds (which, in the U.S., are principally soybeans).

•*The guaranteed loan program*—The single exception in support of soybeans is the guaranteed crop loan program; until this year, it had negligible effect because the loan guarantee price traditionally was pegged below the prevailing market. However, during the past year, an oversupply of oilseeds has driven market prices below the prevailing soybean loan rate, with many farmers ceding their crops to the U.S. government as payment for nonrecourse loans. Thus, the U.S. government has "purchased" 92 million bushels of soybeans from the 1985/86 crop; by next spring, there may be more than 460 million bushels in Commodity Credit Corporation (CCC) storage.

This loan program does not have the same effect on international trade as the EEC rapeseed policy or the Spanish consumption quota. In the short term, this policy tends to remove oversupply from the market and to stabilize world prices (at substantial cost to U.S. taxpayers). It is often argued that the program, when set above market-clearing levels, deters rationalization of U.S. farmland use and makes U.S. soybean farmers uncompetitive with foreign producers.

Over the longer term, it is argued, the program interferes with normal market operation, primarily by depressing world prices through overshadowing the market with the large quantity of soybeans in storage. Such a supply also creates pressure for new concessionary sales programs that can interfere with normal market behavior.

•*PL-480 and GSM credit programs*—U.S. practices affecting oilseed and oilseed product trade most severely criticized by other countries have been the PL-480 "Food for Peace" program and the GSM credit programs.

PL-480 was begun in the 1950s to provide food to developing countries that could not participate in the cash market. Similarly, GSM credit was developed to assist countries that could not arrange reasonable credit sales and did not qualify for PL-480. These programs have been used, among other things, to promote U.S. soybean oil sales.

These programs have been a combination of both food assistance and market development. PL-480 has benefited not only U.S. processors but exporters in other countries as well. The Indian market for imported vegetable oil, first developed by the U.S. under PL-480, is now a major commercial market for Malaysian palm oil and for soybean oil from Brazil and Argentina. Despite their focus on creating market additionality rather than interfering in competitive markets, these programs often are viewed by other exporters as creating market distortions. U.S. policymakers must consider the perception and reality of these programs when considering ways to negotiate elimination of other market distortions.

The major argument against the PL-480 and GSM credit programs is that they create government-assisted sales that "subsidize" the U.S. soybean farmer and processor to the extent that they provide income—thus providing an incentive toward world oversupply. During the 1985/86 crop year, the U.S. exported about 500,000 MT of soybean oil under government-assisted programs—roughly the same amount of oil as the EEC will export

pursuant to its rapeseed policy. Another criticism has been that they lower foreign market prices to the point that it is uneconomic for foreign producers to manufacture in their own countries. It is charged that this represses development of indigenous agricultural production and undermines ultimate self-sufficiency. While these arguments with regard to PL-480 and GSM credit are less direct than with regard to other subsidy practices that are discussed, they are part of the perceived problem.

•*Import barriers*—Other oilseed trading nations, especially Brazil and Argentina, often point to the higher duty barriers in the U.S. and Europe on alternatively sourced vegetable oils as a justification for their own subsidy practices. While the U.S. permits imports of unprocessed soybeans duty free and imposes a fairly low duty on soybean meal, its 22.5% *ad valorem* duty on soybean oil is viewed as significant protectionism.

Brazil

In the Third World and among emerging industrial nations, disruptive government interventions have involved not so much protection of threatened farming interests as promotion of value-added export industries. Brazil, in the late 1970s, was the first nation to develop substantial subsidy programs to assist oilseed processing and oilseed product exports. The result was an unprecedented boom in processing capacity and meal and oil exports. Although Brazil produces roughly one-quarter the amount of soybeans produced in the U.S., it is the world's leading exporter of soybean meal and oil. Brazilian government incentives have been so powerful that its soybean crushing capacity (approximately 25 million MT per year) far exceeds its capacity to grow soybeans (approximately 17 million MT per year).

There is tremendous overcapacity and resulting underuse of plant capability in Brazil. During the current year, Brazil may use less than 50% of its crushing capacity. Government incentives have resulted in uneconomic investment when Brazil is facing a monumental

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international debt crisis. Brazilian exporters must sell at low prices to increase market share in order to obtain foreign currency needed to service the debt. At the same time, the cost to the government of funding this growth continues to increase. In the past several years, Brazil has reduced or eliminated some of its subsidy practices. However, to appreciate fully the degree to which government inter-

was based on the previous year's exports. This program now appears greatly diminished. By August 1986, Resolution 950 financing was limited to vegetable oil at levels of 15% of the previous year's export FOB value. Similar financing under Resolution 643 was available to soybean crushers who sold to export trading companies.

Brazil also established a duty drawback system that enabled

•*Tax exemptions and deductions*—Brazil also provides special tax treatment to enhance export sales of soy products. Export earnings on soy oil are exempt from Brazil's 30% corporate income tax. Special deduction rules allow Brazilian traders to exclude hedging net profit on commodity futures from hedging net losses as a business expense.

Argentina

Argentina, with no significant oilseed product exports before 1977, has become a major exporter of soybean and sunflowerseed oil and meal. While Argentina does appear to have the soil, weather conditions and available land to make it a significant producer of soybeans and sunflowerseeds, its meteoric rise as an exporter of processed protein meal and vegetable oils (rather than the raw soybeans) is linked to government intervention to foster a processing industry.

Argentina's share of the world's export market for unprocessed soybeans has remained fairly constant since 1977/78, increasing from 8.7% then to 10.8% in the 1985/86 crop year. Its share of the processed meal and oil markets has skyrocketed over the same period, with soy meal increasing from 2.3% to 15.4% and soybean oil from 2.9% to 23%.

•*The Reembolso*—Prior to 1982, Argentina used a tax rebate system for oil and meal exports known as the Reembolso to spur growth in its processing sector.

•*The differential export tax system*—Argentina's most dramatic export increases have come since 1982, when it replaced the Reembolso with a differential export tax system that applies significantly higher tax rates to raw soybeans than to soy products. The system, known as a "retention tax" in Argentina, effectively blocks raw soybean exports and retains a surplus of beans in the domestic market at prices well below world market levels. The system, in effect, forces Argentine soybean farmers to accept lower-than-world-market prices, making those low-priced soybeans available to the Argentine crushing industry. A similar tax system is applied to the sunflower-

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vention has contributed to Brazil's current situation, let's review the subsidy practices involved.

•*Differential export taxes*—Brazil imposes a higher export tax on unprocessed soybeans (13%) than on soybean meal (11.1%) or oil (8.0%). The effect is to put Brazilian-grown soybeans in the domestic market below world market prices and to provide an additional crushing margin for Brazilian oilseed processors. The Brazilian practice provides an advantage similar to, although not as great in value as, that provided the crushing industry in Argentina.

•*Preferential export financing*—Throughout the 1970s, Brazil formulated preferential export financing programs for its soybean processing industry. Many of these programs have been substantially cut back or eliminated in recent years, but their impact in promoting the enormous growth of Brazilian crushing capacity is undeniable.

Under Resolution 674 and successor programs (Resolutions 882 and 950), Brazil provided working capital financing of "production to be exported" below market rate. Soybean crushing firms' eligibility

soybean meal and oil processors to obtain preferential financing to import raw materials for domestic processing and re-export. The preferential financing for soybeans was suspended in 1983.

Recent reports from Brazil indicate the government may be intervening through the grant of ICM tax credits on imported soybeans. The specific impact of this tax credit system is being studied.

Brazil also granted preferential credits under a clearing arrangement with Hungary. This permitted Brazilian exporters to capture the lion's share of the Hungarian soy meal import market—approximately 600,000 MT per year in the early 1980s. Trade sources report this practice has been extended to other Eastern European countries as well. The value in 1985 was estimated in the range of \$150 million in sales by Brazil to Hungary.

Brazilian crushers also benefited from a national system of rural credits (EGF loans) that provided funds at subsidized interest rates for the storing agricultural commodities. Soybean processors have been the leading recipients of these loans.

seed and linseed sectors. The Argentine system is similar to the practice adopted earlier by Brazil but more effective in fostering rapid processing industry growth because the tax rate differentials historically have been much greater in Argentina.

The Argentine differential export system presents perhaps the most divisive single issue among the major oilseed producing and processing countries. This practice was one of several subsidy practices cited in Section 301 petitions brought by the U.S. soybean and sunflowerseed industries in 1983. The Argentine system is the central issue in the current Section 301 investigation on soybeans being conducted by the office of the U.S. Trade Representative. The Argentine system was also the subject of a recent complaint to the EEC brought by the European oilseed crushing association (FEDIOL). Recent Brazilian articles and statements have cited the Argentine system as a major source of price depression in world markets for soybean meal and oil, affecting the value of Brazilian exports.

Malaysia

Over the past decade, Malaysia has made major strides in developing its palm oil industry. Malaysian palm oil is the leading edible oil in world trade. Substantial amounts are available at prices that make it an attractive substitute for other vegetable oils. However, despite Malaysia's natural advantages in production of crude palm oil, it also has persisted in assisting its processing industry by developing subsidy practices that significantly lower processing and refining costs.

•*Differential export duty system*—Malaysia, like Argentina and Brazil, has attempted to promote a value-added processing industry through the use of a differential export tax system. In Malaysia, the export tax rates are applied inversely, the tax rate decreasing with increased levels of refining.

The highest export tax rate is applied to unrefined or crude palm oil. The system insures that raw products are available to Malaysian processors at lower-than-world-market prices. This permits Malaysian exports of processed palm oil to compete much more favorably against exports of alternative vegetable oils from other sources.

•*Preexport financing*—The Malaysian government also provides preferential preexport financing to palm oil product manufacturers (but not for exports of crude palm oil). This financing is used for a variety of purposes, including operating capital and export credits.

Canada

Canada also has engaged in subsidy practices to assist its rapeseed industry. In 1982, the Province of Alberta provided a processing subsidy of \$40 per MT to local crushers, whose estimated annual crush was about 600,000 MT. In addition, both the Alberta provincial government and the Canadian federal government have provided financial assistance to underwrite the cost of shipping Canadian rapeseed oil and meal by rail.

Conclusion

The world oilseed market is facing a tumultuous decade. With increasing government intervention in major producing and consuming countries, most everyone appears to be losing. Taxpayers are spending millions to subsidize otherwise profitable operations; Third World farmers are receiving a fraction of the world market price for their crops; processors and crushers are faced with increasing barriers to new and traditional markets; and in some countries, consumers are paying higher prices than are warranted by free market conditions for products.

Sooner or later, the pressures created by subsidization and protectionism will result in economic

disaster. Otherwise profitable enterprises will flounder, and important capital investment will be lost because fair competition has been prevented. Government budgets will be strained by the increased costs of their intervention programs. International trust in the trading system will be badly damaged.

Rather than bemoan the inevitability of this scenario, however, world oilseed producers should ponder the experience of other industries and carefully analyze their options. As noted previously, they have several choices:

- to cartelize world production and prices (surely more unworkable and as subject to cheating as petroleum is);
- to allow totally "free" market forces to predominate, which, of course, carries the hazards of destroying entire market sectors in both developing and developed countries; or
- to agree to a set of trading rules that recognize the development needs of the Third World and the political imperatives of consuming countries and that moderate the opportunities for retaliatory actions.

The opportunities provided by the third option seem obvious, but require a spirit of compromise and negotiation that has been lacking to date. Nevertheless, the chance to consider these matters in the new round of GATT negotiations seems too good to miss.

Both developing and developed countries have too much to lose not to seriously consider the kinds of trading rules that at least approximate those for manufactured products in the milieu of the Subsidies Code and the general rubric of the General Agreement on Tariffs and Trade.

Should countries not address these issues, the result will be perpetuation of anarchy and trade wars which would be the outgrowth of either of the other options.