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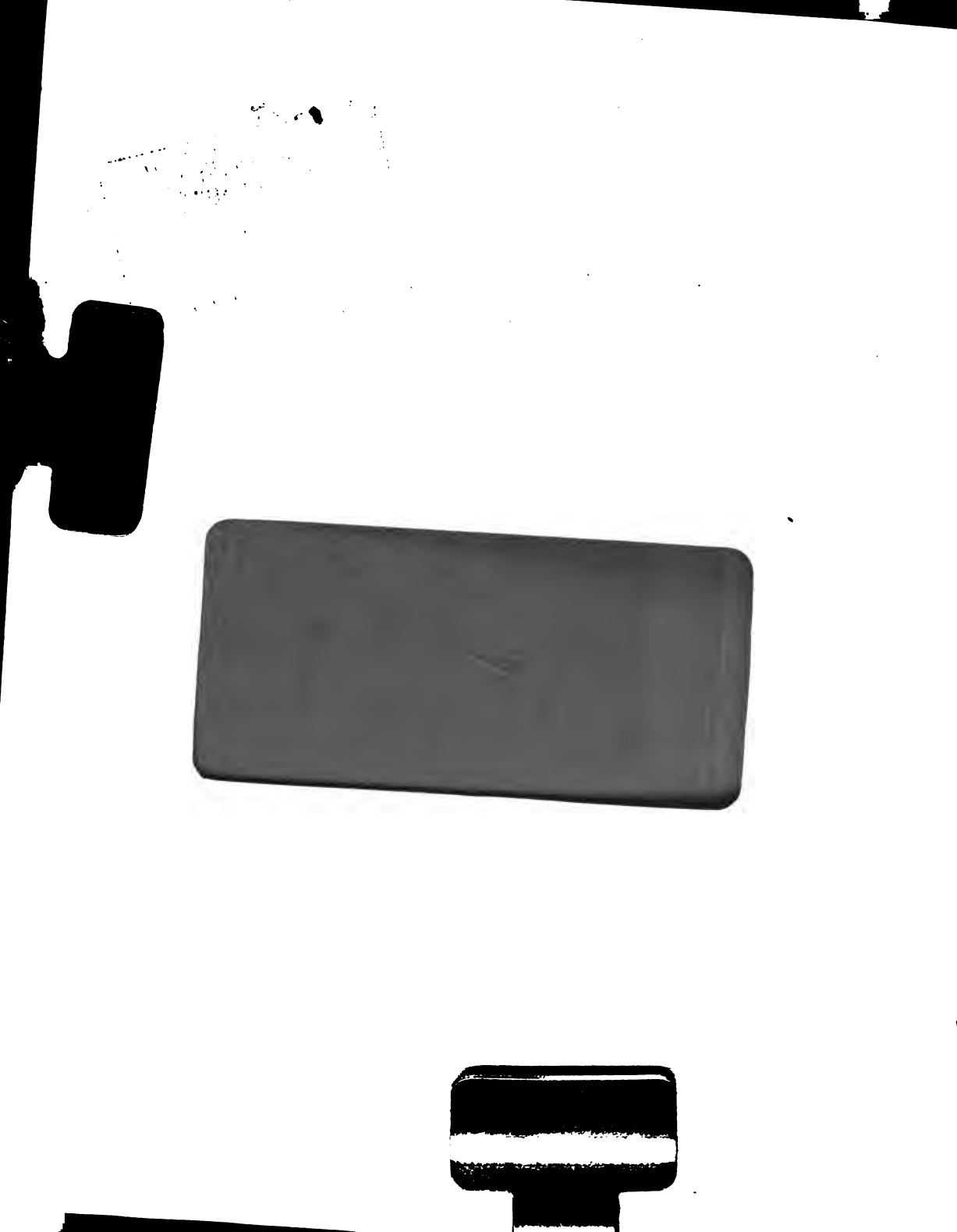


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Consultant Final Report
IICA/EMBRAPA-PROCENSUL II
AGRICULTURAL POLICY, DEVELOPMENT
AND TRADE

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✓ AGRICULTURAL POLICY, DEVELOPMENT AND TRADE

Consultant Final Report
IICA/EMBRAPA-PROCENSUL II

Agricultural trade liberalization and the
developing countries

G. Edward Schuh ✓

Brasília, junho de 1989

INSTITUTO INTERAMERICANO DE COOPERAÇÃO PARA A AGRICULTURA
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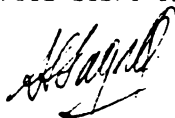
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As atividades de consultoria são realizadas no âmbito do Projeto de Desenvolvimento da Pesquisa Agropecuária e Difusão de Tecnologia na Região Centro-Sul do Brasil - PROCENSUL II, financiado parcialmente pelo Banco Interamericano de Desenvolvimento - BID e a EMBRAPA conforme os contratos de Empréstimo 139/IC-BR e 760/SF-BR, assinados em 14 de março de 1985 entre o Governo Brasileiro e o BID.

As opiniões dos consultores são inteiramente pessoais e não refletem, necessariamente, o ponto de vista do IICA ou da EMBRAPA.

A coordenação dos Contratos IICA/EMBRAPA agradeceria receber comentários sobre estes relatórios.



Horacio M. Stagno
Coordenador Contratos IICA/EMBRAPA



INSTITUTO INTERAMERICANO DE COOPERAÇÃO PARA A AGRICULTURA
CONVÊNIO IICA/ENBRAPA

RELATÓRIO FINAL DE CONSULTORIA

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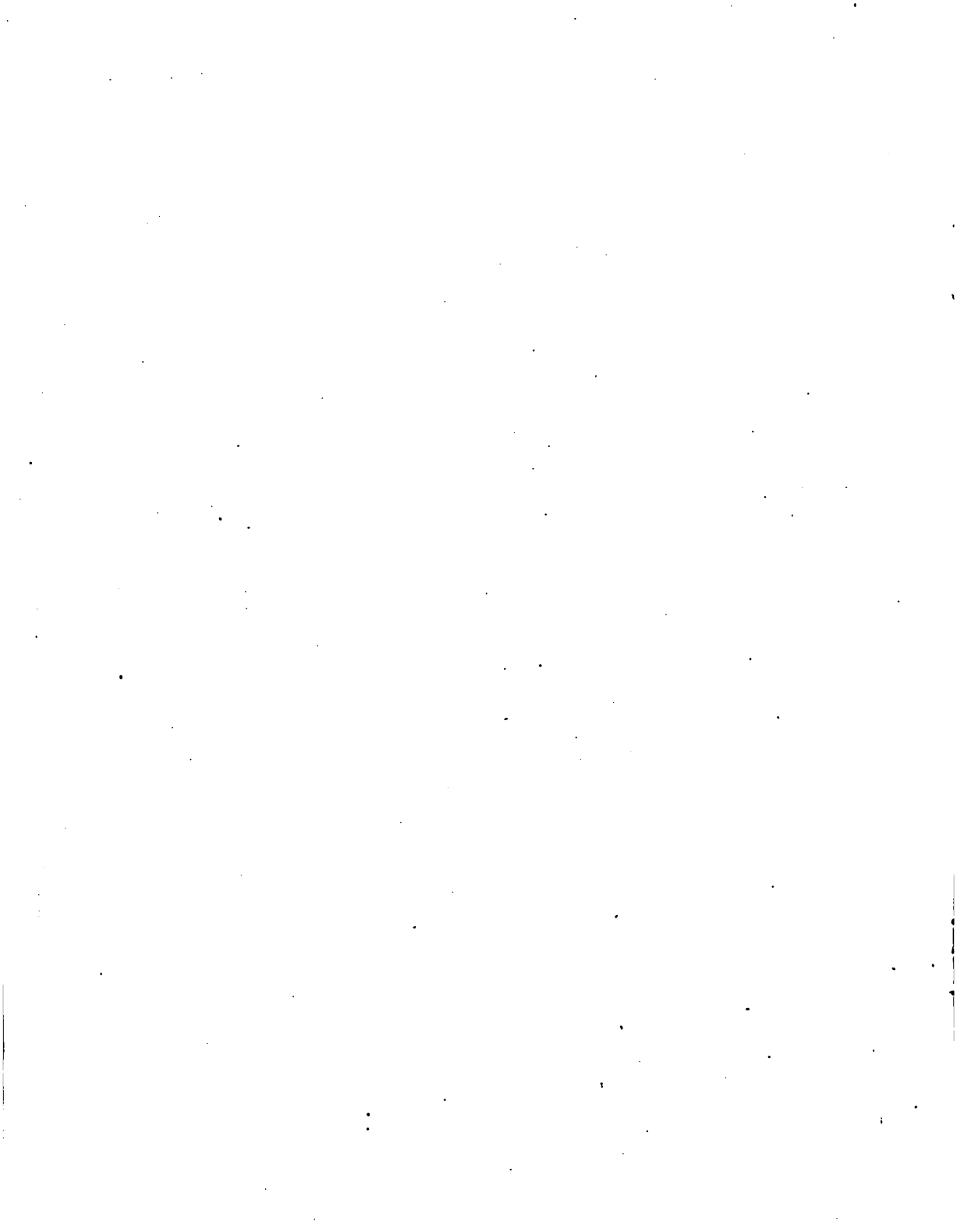
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AGRICULTURAL TRADE LIBERALIZATION
AND THE DEVELOPING COUNTRIES*

G. Edward Schuh**

It is a pleasure for me to be a part of this important seminar celebrating the 45th anniversary of the Agricultural Economics Institute. Forty-five years is a long time for a social science research institute to exist as part of a government policy-making organ. That it has lived so long is a tribute to the leadership it has had over the years. And it has had excellent leadership - people of vision and drive - in the form of Ruy Miller Paiva, Rubens Araújo Dias, Paulo Cidade de Araújo and Alberto Veiga - the people I have known and who have been excellent professional colleagues. My congratulations to all of them for their success.

One also has to congratulate the numerous state Secretaries of Agriculture who have presided over the Secretariat of Agriculture. Those people, as was to be expected, varied a great deal in their knowledge of how to take advantage of the Institute. Rubens Dias, former Director of the Institute, probably knew best how to use the Institute's talents and resources. But my perception is that each of them, in their own way, drew on what the Institute had to offer, and thus used it to improve economic policy, not only in São Paulo, but in the nation

* Presented at International Seminar on Agricultural Policy, celebrating the 45th Anniversary of the Institute of Agricultural Economics, State Secretariat of Agriculture, October 26-28, 1988, São Paulo, Brazil.

** Dean, Hubert H. Humphrey Institute of Public Affairs, University of Minnesota, Minneapolis.

as a whole.

Finally, not much of anything would have happened if it were not for the dedicated staff the Institute has had over the years. Here I have reference to the secretaries, the professional agricultural economists and sociologists, the statisticians, and the data processors and calculators. You all deserve our congratulations for your dedication and perseverance in a situation in which salaries often were low, working conditions not the best, and political instability often unsettling.

When one looks around Latin America, and even around the world, there are few institutions of its kind that one can identify at the national level, let alone at the state level. Institutions such as this one survive because people have worked to make them survive. Institutional development is one of the most difficult professional tasks there is. But difficult as it is, I would like to encourage the current staff and leadership of the Institute to dedicate itself to making the Institute ever stronger in the years ahead.

The chances that I could come back here 45 years from now and participate in another conference like this are not great. However, the chances 10 years from now are a bit better. Thus, I hope that when we reconvene in 1998 to celebrate the Fifty-Fifth Anniversary of the creation of the Institute we will find it tremendously strengthened from what it is now.

Let me now turn to my topic for the day - trade liberalization and the developing countries. In discussing this

topic I must confess to having a rather unorthodox position. I find that I differ a great deal with my professional colleagues on what the real issues are in global trade negotiations. Moreover I believe the exercise now taking place in Geneva is ignoring some of the major issues on the international scene and thus is doomed to failure. Unfortunately, failure in that exercise will use up a lot of political capital and make it difficult to come back to the table for another round.

I want to divide the remainder of my comments into two parts. First, I will discuss what I believe is wrong with the present trade negotiations. Second, I want to make some suggestions on how I believe the process should proceed, and where I think the greatest potential for liberalization exists. At the end I will have some concluding comments.

What's Wrong With the Present Negotiation

One of the first, and perhaps most important things wrong with the Multilateral Trade Negotiations taking place in Geneva is that they are almost completely ignoring monetary issues. These issues are important for a number of reasons.

First, distortions in exchange rates are equivalent to distortions to trade. For example, an overvalued currency is equivalent to a tax on exports and a subsidy on imports. An undervalued currency, on the other hand, is equivalent to a subsidy on exports and a tariff on imports. The size of these distortions can be quite large, and in actual practice have been quite large. Most of the distortions have been on the side of

over-valued currencies, with most developing countries overvaluing their currencies in one degree or another. In fact, an overvalued currency has undoubtedly been the most widely practiced trade distortion in the world.

Japan has probably made the most extensive use of undervalued currency. When Japan finally let the yen come to a near float a couple of years ago, we saw just how far out of line it had been. The realignment relative to the dollar was really quite large. More recent examples of countries undervaluing their currencies are Argentina and Mexico in Latin America, and South Korea and Taiwan in Asia. Argentina and Mexico have undervalued their currencies in an attempt to generate more foreign exchange to service their international debt. South Korea and Taiwan did it simply by keeping their currency pegged to the value of the dollar when the dollar fell.

A concern as we look to the future is that more and more countries will undervalue their currencies. Developing countries in particular will be driven to do this in efforts to service their foreign debt. But as the global economy becomes more competitive, we may find even the developed countries doing it. Needless to say, we could quickly get caught up in a wave of competition devaluations that could lead to a collapse in international trade, much as we had in the 1930's.

I want to make two additional points about over-valued currencies before going on to consider the second thing wrong with current trade negotiations. First, national.

currencies, especially in developing countries such as Brazil, are often more distorted than meets the eye. Exchange rates reflect the level of protection in an economy. The more protection of domestic sectors there is, the more the nation's currency will tend to be overvalued, other things being equal.

Brazil has over the years pursued a persistent policy of import-substituting industrialization. Not only has the protection of the industrial sector been high, but over time it has encompassed an ever larger part of the economy. Thus, over time, the cruzeiro/cruzado has become increasingly overvalued. The significance of this is that the implicit taxation of the export sectors and the sectors which compete with imports is much greater than it is generally perceived to be. The corollary is that the stimulus to the export sectors and the sectors that compete with imports from a shift toward free trade - toward liberalization of protectionist measures - would be much greater than is generally expected.

The second additional point is that foreign exchange markets in today's world are driven largely by international capital markets, not international trade flows. These international capital flows tend to be about 20 times larger than the flows of international trade. Consequently, international capital markets tend to be an important source of distortions to international trade, since they tend to distort exchange rates. The solution to this problem goes directly to issues of monetary and fiscal policies, which I will take up in the next section of my paper.

Now let me turn to what I consider to be the second thing wrong with the present agricultural trade negotiations, which is the failure to consider the trade distorting policies of the developing countries. The truth of the matter is that the negotiations in Geneva tend to focus on two issues: (1) the issue of access or the barriers to imports imposed by the European Economic Community, Japan, and the United States; and (2) the use of export subsidies, as in the case of the ongoing export war between the United States and the EEC. As noted, these tend to be developed country trade issues, and leave aside barriers to trade imposed by the developing countries.

Trade barriers by developing countries tend to be generally different than those imposed by the developed countries. Rather than limiting access and protecting their agricultural sectors, the developing countries tend to discriminate against their agriculture. They do this by overvaluing their national currency, by imposing a whole range of export taxes and complicated export licensing schemes, and by placing limits and embargoes on their exports. The difference between the two sets of countries can be summarized in the following way. In the developed countries, the farmers line up the government; in the developing countries, the government lines up the farmers.

Thus, rather than to limit the access of producers in other countries to their markets, the developing countries limit the access of their producers to other markets. The tariff protection the developing countries provide to their manufacturing sector is a further implicit export tax on their agricultural producers since they tend to make the cost of their inputs be higher.

Now, the important point is that these barriers to exports, and implicit subsidies to imports, are every bit as important as distortions to international trade as are the barriers to imports that receive so much attention. They send false incentives to producers in other countries, causing agricultural output to be increased in higher cost areas of the world and reduced in the lower cost parts of the world. Empirically, given the share of agricultural output that is produced in the developing countries and the size of the distortions, those distortions to agricultural trade are much more important than are those that limit access to markets in the developed countries.

When I have raised this issue in other fora, it elicits a rather interesting response. The frequent response is that if developing countries want to shoot themselves in the foot in this way, let them. There isn't anything that can be accomplished by international negotiations to stop them.

This response is rather strange. The developed countries inflict wounds on themselves in the same way by protecting their agricultural sectors. The only difference is that the wounds are on their consumers and taxpayers, not their producers. Why do we assume this dissymmetry in treatment ?

The more serious issue, of course, is that these policies contribute every bit as much, if not more, to inefficient use of the world's agricultural resources than do the policies of the developed countries. When the two sets of policies are combined the results is that a significant, if not major, share of the

world's agricultural output is produced in the wrong place. All too much of it is produced in the high cost developing countries, and all too little in the low cost developing countries. The result of this inefficient use of the world's agricultural resources is to sacrifice global agricultural output, and with it, national income on a global scale. This is an international issue, not just a problem of individual nations.

Finally, the third thing wrong with the current round of trade negotiations is the lack of participation by the developing countries. The GATT was started as a rich man's club that focused primarily in the beginning on the reduction in tariffs on manufactured products by the industrialized countries. It was an ad hoc response to the failure of the U.S. Congress to ratify the treaty that would have established the International Trade Organization (ITO), an organization that would have dealt with trade and investment policy on a broad scale.

Over the years the mandate of the GATT has broadened, and the participation of the developing countries has increased. But the participation of these countries is still far short of what it should be. Instead, even when the developing countries sign the charter, they still ask for exceptions and special treatment. Unfortunately, that is not the way to get the efficiency in their economies that they need so badly. Moreover, as long as they are asking for special favors, they don't get the respect from the developed countries that they need and deserve.

Developing countries have a special reason for wanting to belong to the GATT and for taking advantage of its rules and

codes. If these countries are serious about their agricultural sectors, they have every reason for wanting to eliminate the export subsidy war between the U.S. and the EEC. If they belong to the GATT, they have every right to put up protectionist barriers to offset the effect of the export subsidies.

The puzzle is why they don't do this. Surely, if enough developing countries did, the cost to the Treasuries of the U.S. and the EEC would be so great that they would soon bring their domestic policies into lines. The fact that they don't is just as surely a consequence of their desire to subsidize their consumers and discriminate against their agricultural producers.

How More Extensive Trade
Liberalization Might Be Obtained

I frankly believe that there is little chance of significant trade liberalization without prior reform of the international monetary system. No amount of negotiation in my view will attain a lasting liberalization in trade as long as we continue to have large monetary disturbances. We can negotiate for three years in Geneva, and at the end of the day have an agreement that everybody will agree to. Then, on the very next day, when there is a significant monetary disturbance, the agreement will be broken. The experience of the Tokyo round has been essentially this. We all should remember how protectionist pressures in the United States grew in the first half of the 1980's when the dollar grew so strong. Moreover, a lot of the protection in developing countries such as Brazil is in large part an offset to

their overvalued currencies.

The issue is, where does one start to obtain monetary reform? I have discussed this issue elsewhere,¹ and won't go into it in detail here. The problem we have today is that the United States is essentially central banker for the world because the world is for all practical purposes on a dollar standard. Unfortunately, the United States doesn't manage its monetary policy as if it were central banker for the world. Instead, it manages it basically to meet domestic economic conditions. Only when there is a serious crisis on the international scene does it take those conditions into account, in the process imposing large shocks both on its own economy and on the rest of the world as well.

I don't expect global monetary reform to come soon, unless there should be a major crisis, largely because the United States resists it. The United States has opted instead for a system of coordinating macroeconomic policies among the major industrialized countries, a system I have very little faith in.

However, I believe we could negotiate an agreement that could give us more monetary stability, and thus provide the base for freer trade and eventually trade liberalization. What should be our goal? I believe it should be in two parts: (1) first, we need to seek exchange rates that are closer to their equilibrium levels; and (2) we need to seek the fiscal and monetary policies

¹ Schuh, G. Edward, The United States and the Developing Countries, An Economic Perspective, National Planning Association, Washington, D.C., 1986.

that would make that possible.

The first step to getting exchange rates closer to equilibrium levels and more stable in real terms is to establish fiscal and monetary policies that do not induce distortions in exchange rates. Two conditions are needed for this. First, Federal budgets need to be balanced. Second, monetary policies need to be such as to create a stable price level in individual countries.

None of this will be easy, either for countries such as Brazil or for the United States. However, we need to establish explicitly the links between monetary and fiscal policy and the real exchange rate, and the link between the exchange rate and trade liberalization. Once we do, we have a stronger basis for attaining these policy goals, since it will be possible to bring the full power of the moral suasion of the international community to bear on these issues.

The next issue is one of exchange rate stability. Attaining the above policy goals would add a great deal to exchange rate stability. However, as long as we have the present mixed system of bloc-floating exchange rates, we will still have instability in foreign exchange markets. What is needed is a system of generalized floating. If we are to have more stable exchange rates, everybody has to share in the adjustment to shocks to the system. If they don't, the burden of adjustment will be thrown on that part of the system where there is flexibility. But the instability is not limited to those markets as long as we have a

bloc-floating system. Instead, there will be a great deal of implicit instability, as we now have.

Unfortunately, there is a great deal for pressure today to go back to the old days of the Bretton Woods fixed exchange rate system. To argue in that way is to fail to recognize why the Bretton Woods system was abandoned in the first place. It was abandoned because the huge flows of international capital made it impossible to fix exchange rates for any extended period of time.

Ironically, it is the Europeans who make the loudest clamor for fixing exchange rates, in the process citing their own supposed success with the European Monetary System. But in that argument, they are very similar to their posture on commodity markets. They can have stable markets as long as they fail to share in international adjustments, and as long as they dump their adjustment problems abroad. That is hardly, the basis for developing a sound international system.

The third step in attaining global trade liberalization is to introduce distortions in exchange rates as part of the discussion over trade policies. To ignore these distortions is to ignore a great deal of what is important. We can't have serious discussions of trade distortions unless we consider the full range of such distortions.

Finally, I am a pessimist about what can be obtained through Multilateral Trade Negotiations. I am not so much of a pessimist that I am willing to abandon them completely. But I do believe we need to be developing other approaches.

The various attempts at economic integration we see taking place on the international scene in my judgment offer important opportunities for more general reductions in barriers to international trade. The first of these attempts at international economic integration is the trade agreement between Canada and the United States. The US Congress has already ratified the treaty establishing this agreement. Canada is expected to do so after the upcoming election in that country.

The next big exercise in economic integration is the EEC 1992. That initiative proposes to eliminate all barriers to trade among the EEC-12, and to eliminate barriers to flows of flows of labor and capital among the twelve countries as well. The economic unit which results will be a huge market. Its GNP will be larger than that of the of the United States, as will its population. Its per capita income will be about that of the of the United States. capita income will be about that of the United States.

The issue is whether the EEC will raise its external barriers to trade at the same time it reduces them domestically. If it does, it will set us back on trade liberalization and probably reduce its own impetus for growth. If it should avoid raising and possibly even reduce its protectionist measures, it will create a market comparable but larger to that of the United States.

The potential of this market is causing many to argue that the United States and Canada should persuade Mexico to join them as part of a North American Common Market. Others argue that Japan should join the US and Canada. Still others argue that Japan should join up with its allies in Southeast Asia.

My point is that these integrated units, if they do in fact come off, will be significant sources of economic growth on the international scene. The potential for increasing returns will be great, and in the case of the North American Common Market, there is sufficient difference in resource endowment that realizing comparative advantage should be a significant stimulus to economic growth.

These newly created free trade markets offer important opportunities for further reduction in trade barriers. The United States and Canada, and perhaps eventually Mexico, can simply agree to accept any other country that is willing to live by the same rules they have agreed to live by themselves. The size of the newly created market should provide ample incentives for other countries to agree to enter the market. The same could be done by the EEC, and by Japan if it should eventually create its own common market.

Clearly, there will be adjustment costs in first creating these integrated markets and then expanding them. Policy makers should attempt to address these adjustment problems as soon as possible. The quicker these problems can be alleviated, the quicker the benefits from integration will be realized and the sooner it will be possible to add additional "space" to the market.

Increased economic integration on a piecemeal basis such as this is not without its problems, of course. But it may be the way with the most potential in the near future. The simultaneous liberation of factor and product markets should reduce

the need for large adjustments on any particular side of the market. Similarly, the economic growth this integration makes possible makes it easier to deal with adjustment problems.

Concluding Comments

Let me conclude by emphasizing two points. The first is the importance of dealing with the monetary issues. Back in the immediate post - World War II period international capital markets could be safely ignored since they were of little significance. But that is not the case today. These markets are now huge and powerful, and literally drive foreign exchange markets. But recognizing the significance of international capital markets takes one directly to the importance of monetary and fiscal policies and the need to reduce and minimize the significance of distortions in foreign exchange markets.

Second, developing countries such as Brazil have much to gain from integrating themselves more fully into the international economy. Breakthroughs in the transportation and communication sectors have significantly reduced the costs of transportation and communication services. These reductions in costs make it possible to capitalize more effectively on comparative advantage, specialization, and the international division of labor. Developing countries have much to gain from realizing these benefits. But they also have much to gain from the increased efficiency that comes from exploiting market opportunities abroad and from forcing domestic sectors of the economy to compete. In the final analysis, these may be the most significant benefits from global liberalization in trade, for it is the consumers who benefit, not a small group of producers.

Programa II. Geração e Transferência de Tecnologia

O Programa de Geração e Transferência de Tecnologia é a resposta do IICA a dois aspectos fundamentais: (i) o reconhecimento, por parte dos países e da comunidade técnico-financeira internacional, da importância da tecnologia para o desenvolvimento produtivo do setor agropecuário; (ii) a convicção generalizada de que, para aproveitar plenamente o potencial da ciência e da tecnologia, é necessário que existam infra-estruturas institucionais capazes de desenvolver as respostas tecnológicas adequadas às condições específicas de cada país, bem como um lineamento de políticas que promova e possibilite que tais infra-estruturas sejam incorporadas aos processos produtivos.

Nesse contexto, o Programa II visa a promover e apoiar as ações dos Estados membros destinadas a aprimorar a configuração de suas políticas tecnológicas, fortalecer a organização e administração de seus sistemas de geração e transferência de tecnologia e facilitar a transferência tecnológica internacional. Desse modo será possível fazer melhor aproveitamento de todos os recursos disponíveis e uma contribuição mais eficiente e efetiva para a solução dos problemas tecnológicos da produção agropecuária, num âmbito de igualdade na distribuição dos benefícios e de conservação dos recursos naturais.

INSTITUTO INTERAMERICANO DE COOPERAÇÃO PARA A AGRICULTURA

O Instituto Interamericano de Cooperação para a Agricultura (IICA) é o organismo especializado em agricultura do Sistema Interamericano. Suas origens datam de 7 outubro de 1942, quando o Conselho Diretor da União Pan-Americana aprovou a criação do Instituto Interamericano de Ciências Agrícolas.

Fundado como uma instituição de pesquisa agrônômica e de ensino, de pós-graduação para os trópicos, o IICA, respondendo às mudanças e novas necessidades do Hemisfério, converteu-se progressivamente em um organismo de cooperação técnica e fortalecimento institucional no campo da agropecuária. Essas transformações foram reconhecidas oficialmente com a ratificação, em 8 de dezembro de 1980, de uma nova convenção, que estabeleceu como fins do IICA estimular, promover e apoiar os laços de cooperação entre seus 31 Estados membros para a obtenção do desenvolvimento agrícola e do bem-estar rural.

Com um mandato amplo e flexível e com uma estrutura que permite a participação direta dos Estados membros na Junta Interamericana de Agricultura e em seu Comitê Executivo, o IICA conta com ampla presença geográfica em todos os países membros para responder a suas necessidades de cooperação técnica.

As contribuições dos Estados membros e as relações que o IICA mantém com 12 Países Observadores, e com vários organismos internacionais, lhe permitem canalizar importantes recursos humanos e financeiros em prol do desenvolvimento agrícola do Hemisfério.

O Plano de Médio Prazo 1987-1991, documento normativo que assinala as prioridades do Instituto, enfatiza ações voltadas para a reativação do setor agropecuário como elemento central do crescimento econômico. Em vista disso, o Instituto atribui especial importância ao apoio e promoção de ações tendentes à modernização tecnológica do campo e ao fortalecimento dos processos de integração regional e sub-regional.

Para alcançar tais objetivos o IICA concentra suas atividades em cinco áreas fundamentais, a saber: Análise e Planejamento da Política Agrária; Geração e Transferência de Tecnologia; Organização e Administração para o Desenvolvimento Rural; Comercialização e Agroindústria, e Saúde Animal e Sanidade Vegetal.

Essas áreas de ação expressam, simultaneamente, as necessidades e prioridades determinadas pelos próprios Estados membros e o âmbito de trabalho em que o IICA concentra seus esforços e sua capacidade técnica, tanto sob o ponto de vista de seus recursos humanos e financeiros, como de sua relação com outros organismos internacionais.

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