KANSAS WHEAT PRODUCER

Alan E. States

Growing wheat in Kansas, as I do, is a long way from the Canadian border. As a result of geographic separation, maybe I can be a little more objective about the trade issues involved in U.S. imports of wheat and durum than growers close to the border. My objective is to be controversial enough to give you pause the next time you listen to the details of some trade dispute.

The North American Free Trade Agreement expresses a philosophy that the inhabitants of the continent will be better off with free and open trade among its citizens, than they would be by maintaining trade barriers. We are here today to report on the progress of that grand endeavor. In general, we may be living up to the terms of the agreement but we have a long way to go to accomplish the mission. Just as the Articles of Confederation were replaced by the Constitution, the NAFTA needs to be improved.

Free trade can be compared to a three-legged stool. If any of the legs break the stool falls over. A good trade agreement also has three legs to hold it up: if any of these legs are weak the agreement will fail:

- the first is elimination of tariff barriers;
- the second is elimination of non-tariff barriers;
- the third is elimination of trade distorting incentives to produce.

The first leg, the elimination tariff barriers, is the easiest to construct. Tariffs are visible and can be phased out over time. The second leg, non-tariff barriers, is tougher. These barriers may be import quotas. However quotas can be changed to tariffs and then phased out. More often non-tariff barriers come in other forms and are easier to hide or rationalize. They may come disguised as health or environmental regulations.

The third leg, elimination of trade-distorting incentives to produce, is also difficult to handle. These incentives are usually domestic programs in support of the income of local producers. They come in many forms.

For example, product specific transportation subsidies or preferences translate into higher local prices for producers. Producers are encouraged to produce more, which usually results in lower prices both for themselves and their competitors around the world. Product specific tax preferences work the same way. Similarly subsidized carrying costs, either in the form of storage subsidies or low interest loans, also translate into higher income and increased incentives to produce. Marketing loans are also highly trade distorting for the same reasons, as are price support loans, intervention prices, export subsidies and area payments that are coupled to plantings.

Effective state trading organizations may also be trade distorting to the extent that they may hide state subsidies in the form of low cost operating funds, have inordinate powers to distort freight rates, and restrict domestic supply to local consumers.

Of course the grass is always greener in the other side of the hill. We need to be cognizant to the danger that we may get what we are asking for. The United States fought for the elimination of subsidized freight rates in Canada. Termination of that subsidy led to restoration of the natural flow of grains to the south rather than to the far west.

The Canadian Wheat Board is doing a disservice to the better farmers in Canada, many who would be better off if they had free trade within their own country. The CWB wants monopoly powers to shield itself from more efficient domestic competition. While the CWB is a trade irritant, the elimination of its monopoly powers could be a nightmare-come-true for U.S. producers. Why is that? It is because Canadian wheat farmers may be more competitive than their U.S. counterparts. Farmers in the States have been telling themselves for years that they are the most efficient wheat producers in the world. That may no longer be true. Australia, Argentina as well as Canada may have lower costs of production than the United States. That is the case because the U.S. Farm Program, with its marketing loan, supports income, which in turn is capitalized into the price of land, ultimately drives production costs higher making U.S. producers non competitive. U.S. farmland prices have been surprisingly strong in the face of low market prices.

This capitalization is also expressed even more blatantly in Europe where area payments, intervention prices and export subsidies support the income of European producers and are capitalized into land prices which clearly make the European farmer non competitive and dependant on the welfare state and the VAT. The fact that the EU's area payments are in the WTO blue box rather than the amber box says more about the Europeans negotiating skills than economic reality.

Income and tax subsidies can only be trade neutral when they come completely de-coupled from plantings and production. Distorting trade practices are counter-productive. Let me explain.

Wheat is a commodity just like a personal computer. Every year someone can make a computer better, faster and cheaper than before. The same holds true with wheat. In real terms, commodity prices tend to decline over time. This is what gives us all a higher living standard. This is a piece of the Great American Dream. When trade groups, whether they represent wheat, textiles or dock workers, fail to recognize this and are also powerful enough to impose protectionist measures to aid their constituents, they are being penny wise and pound foolish. Rather than encouraging their industry to adapt to change as it occurs, they protect it from change until the change is overwhelming and can no longer be held back. Then the dam bursts and the domestic industry is swept away in the flood that follows. While the distorting trade practices were in effect, the domestic consumers paid a higher price than needed, they also may have paid higher taxes to support the cost of the program and foreign competitors were damaged. The protected party ultimately was harmed because the protection from competition made him even less competitive and ultimately less able to survive in the long run. We have seen this happen time and again when great nations such as China and Japan turned inward and were bypassed by the rest of the world.

The Internet was not a factor when NAFTA was signed. The world has changed dramatically in the short period since 1995. The CAP of the EU, U.S. price support programs and the monopoly powers of the CWB are dinosaurs whose time has come and gone. Let them die gracefully.

The existence of these holdovers from the past may be allowed because they are within the letter of the NAFTA and WTO agreements. But their continued existence indicates that we have not yet accomplished the mission of open markets. That will only occur when a Canadian wheat farmer can sell his product to the highest bidder whether it be a local miller, an elevator in Fargo, or the CWB, and when a North Dakota grower can deliver wheat to a Canadian processor with same ease as going to his local elevator. As well, it will only occur when these producers receive prices which are genuinely reflective of market based demand and supply in the major producing and consuming countries.