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SUBSIDIES, TARIFFS AND TRADE WARS: A TERRIBLE HARVEST FOR U.S. AGRICULTURE

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INTRODUCTION

From abandoned international leadership to trade wars to record flooding, the last several years have been brutal for the American agriculture industry. Instead of thoughtfully addressing the problems, the response from policymakers has been woefully inadequate—and in certain cases, made serious reform more difficult.

Shortly after he was inaugurated, President Trump withdrew the United States from the Trans-Pacific Partnership (TPP), a trade agreement with 11 other Pacific Rim nations. The TPP cut tariffs on both sides of the Pacific, opened up Asian agricultural markets for American producers and provided an alternative market to China in the region—with a dispute resolution framework and the rule of law. While imperfect, the TPP was a potentially potent tool to establish supply chains outside of China and raise commercial standards in the region. Likewise, it would have been a major boon to American agriculture exporters who are desperate for new foreign market access. After the United States withdrew, the remaining members moved forward with the agreement and now American farmers and ranchers face higher tariffs than many of their competitors in a vital and growing region.[1]

In 2018, President Trump began a series of trade wars with a number of countries—most prominently with China. Washington's litany of complaints about Beijing's trade policy practices were documented in a lengthy report issued by the United States Trade Representative (USTR), including forcing American firms to transfer technology to Chinese firms as a condition of entering the Chinese market, intellectual property abuse and theft of trade secrets.[2] The crux of USTR's argument is that many firms in China do not operate on market-oriented terms and enjoy lavish subsidies from the central government, and that such policies unfairly burden American firms who seek to access China's market.

After the report, the United States imposed tariffs on a number of imported products from China.[3] In turn, China retaliated with the brunt falling on agricultural products.[4] The tariff retaliation between Washington and Beijing went back and forth a number of times before the two sides signed the so-called "Phase One" agreement in January 2020.[5]

On top of the trade war with China, floods ravaged parts of the country in 2019, which delayed planting of a number of crops.[6] As a result, the United States Department of Agriculture (USDA) reported that nearly 20 million acres of cropland went unused in 2019.[7] In early 2020, COVID-19 spread around the globe and economies, including the United States, began to soften.

In response to declining foreign market access from the trade wars and the outbreak of the pandemic, Washington has heavily subsidized American agricultural producers. This policy brief will take stock of the current situation American farmers and ranchers face and make concrete recommendations for policymakers hoping to reform the unsustainable status quo.

SCORING THE TRADE WAR AND WASHINGTON'S RESPONSE

The president's unilateral trade war with China has exacted a heavy toll on the economy, particularly for America's farmers and ranchers.

Broader Economy

Even after Washington and Beijing signed the so-called "Phase One" agreement, tariffs cover over $300 billion of imports from China.[8] The average tariff is "more than six times higher than before the trade war began in 2018."[9] Additionally, countless studies have confirmed that American consumers, not Chinese exporters, are paying the tariffs, despite the president's repeated assertions to the contrary.[10]

Because a large percentage of imports from China are intermediate inputs and capital goods that American firms use to manufacture products domestically, the tariffs hurt the manufacturing industry. Thus, by raising the costs of these products through tariffs, the manufacturing industry became less competitive globally. In 2019, despite an otherwise growing domestic economy, the manufacturing industry slipped into recession.[11]

Likewise, a recent study from the New York Federal Reserve Bank found that: "[T]he trade war reduced U.S. investment growth by 0.3 percentage points by the end of 2019, and is expected to shave another 1.6 percentage points off of investment growth by the end of 2020."[12] This amounts to a $1.7 trillion loss in market capitalization.[13]

Agriculture

In addition to the lost investment and higher prices for consumers, American agricultural exporters faced significant, retaliatory tariffs from Beijing. To meet its demand, China increasingly turned to Brazilian and Argentinian farmers.[14] Indeed, in 2018, the value of U.S. agricultural exports to China fell by more than 50 percent from 2017 levels, the last year before the trade war began.[15] The picture in 2019 was not much better. Total agricultural exports to China were about $15 billion in 2019, down from about $24 billion in 2017.[16]

The toll has been significant. Farm bankruptcies skyrocketed by more than 20 percent in 2019 as sales plummeted.[17] More grim, there is evidence that the trade wars caused a spike in suicides among farmers.[18] Despite the détente with Beijing and improved planting conditions over last year, prices for agricultural commodities remain depressed.[19] A recent news story succinctly summarizes the current situation:

> Chinese imports of U.S. corn, soybeans and wheat are 144% higher than they were at this point last year, according to data from the USDA's Foreign Agricultural Service. But the onset of the coronavirus pandemic in the U.S. in March hobbled domestic demand for grains as restaurants and other institutions nationwide shut down.[20]

This combination has created an untenable situation for America's farmers and ranchers.

Bailouts and Managed Trade

In order to compensate for the lost market access from the trade wars, the Trump administration dusted off a New Deal-era program, the Commodity Credit Corporation (CCC), and lavished nearly $30 billion worth of subsidies on the beleaguered agricultural industry.[21] Many question whether these payments are flowing to politically favored agricultural interests.[22] And, as is the case with virtually all agricultural subsidies, wealthy farms are disproportionately benefiting from the program.[23] Indeed, a recent study found that: "Federal income subsidies in 2020 will total at least $63 billion and account for at least 50 and up to 74 percent of net farm income, the highest level ever recorded."[24]

As R Street has documented, these payments under the CCC raise a number of red flags.[25] For starters, the bailouts are expensive: the roughly $30 billion worth of aid is on top of 2018's farm bill that the Congressional Budget Office (CBO) estimates will cost about $900 billion over a ten year period.[26] Next, like a number of programs within the farm safety net, the CCC payments may cause environmental damage particularly to water quality.[27] Finally, these subsidies create more trade-distorting, non-tariff barriers. Under the World Trade Organization's (WTO) Agreement on Agriculture, the United States agreed to limit trade-distorting subsidies to $19.1 billion per year. With the extra CCC payments, the United States has potentially exceeded its commitments, which opens the nation up to litigation and potentially more tariffs on exports.[28] WTO members are already asking questions about the subsidies.[29] In other words, these payments could spell trouble for American farmers and ranchers if policymakers continue to use the CCC in this way.

PHASE ONE COMMITMENTS

On top of the bailout payments, Washington and Beijing signed the "Phase One" agreement in January 2020. As part of that agreement, the tariffs will remain in place, but China committed to purchasing specific quantities of a number of American exports, including agricultural products.[30]

Among commitments on intellectual property and technology transfer, China agreed to purchase about $80 billion worth of agricultural products over the next two years.[31] As Chad P. Bown of the Peterson Institute for International Economics explains: "For covered agricultural products, China committed to an additional $12.5 billion of purchases in 2020 above 2017 levels, implying an annual target of $36.6 billion."[32] This provides some relief for struggling farmers, but there are still persistent problems with this managed trade approach.

Perhaps all of this damage to the American economy, and particularly the agricultural economy, might be justified if China were changing its economic model in a market-oriented way, but early evidence suggests that not much has changed. Through July 2020, China is not on track to meet its purchase targets.[33] Likewise, in its attempt to meet some of its commitments, Beijing is relying on state-owned enterprises, which is the opposite of Washington's stated demands that China act on more market-oriented terms.[34] Meanwhile, Beijing's technology transfer requirement, which formed a major basis of the USTR's complaints about China's business practices, appears to be getting worse. Indeed, a survey from the US-China Business Council, which represents American companies operating in China, found that 13 percent of the companies said they were asked to transfer technology to their Chinese-based joint venture partners—up from five percent in 2019.[35] In other words, the trade war has caused enormous pain for Americans, but little change to China's economic model.

RECOMMENDATIONS

First, recognizing that the tariffs have hurt the U.S. economy and failed to achieve their stated aims to reform China's economic model, policymakers should remove the tariffs. In turn, China will remove its retaliatory tariffs. Policymakers could then eliminate the troubling payments made under the CCC.

If this ideal is politically impossible, policymakers should put firm limits on the CCC payments to ensure that potentially trade-distorting subsidies remain below the $19.1 billion annual cap the United States agreed to at the WTO. Policymakers should also look at ways to place guardrails on the CCC payments to prioritize conservation and remove marginal lands from productive uses. There is no sense in continuing to subsidize water degradation. Likewise, policymakers need better oversight of the CCC payments to ensure that they are not politically motivated.

Other potential reforms include rejoining the TPP, which would have a two-fold benefit. First, U.S. farmers and ranchers would reach more customers in the Asia-Pacific region—dramatically expanding market access in a vital region. Second, while not a silver bullet, the TPP was designed to provide an alternative market structure to countries in China's geographic orbit. In other words, it may help raise commercial standards in the region—a bulwark against the abusive practices the United States complained about in its initial report that formed the basis of the trade war.

Finally, over the long term, policymakers should look at paring back the farm safety net. The largest bargaining chip the United States has to get other countries to lower their own trade barriers is to lower our own, including the use of non-tariff barriers like agricultural subsidies. A credible commitment from the United States to discipline farm spending would go a long way toward jumpstarting multilateral trade talks at the WTO.

CONCLUSION

The trade wars and accompanying bailout payments have been enormously costly to America's farmers and ranchers as well as taxpayers. Despite the heavy toll, early indications are that China has not made significant changes to its economic model and is falling short on its purchase commitments. A wholesale rethinking of our approach to China is urgently needed and farmers and ranchers stand to benefit from a new trajectory.

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