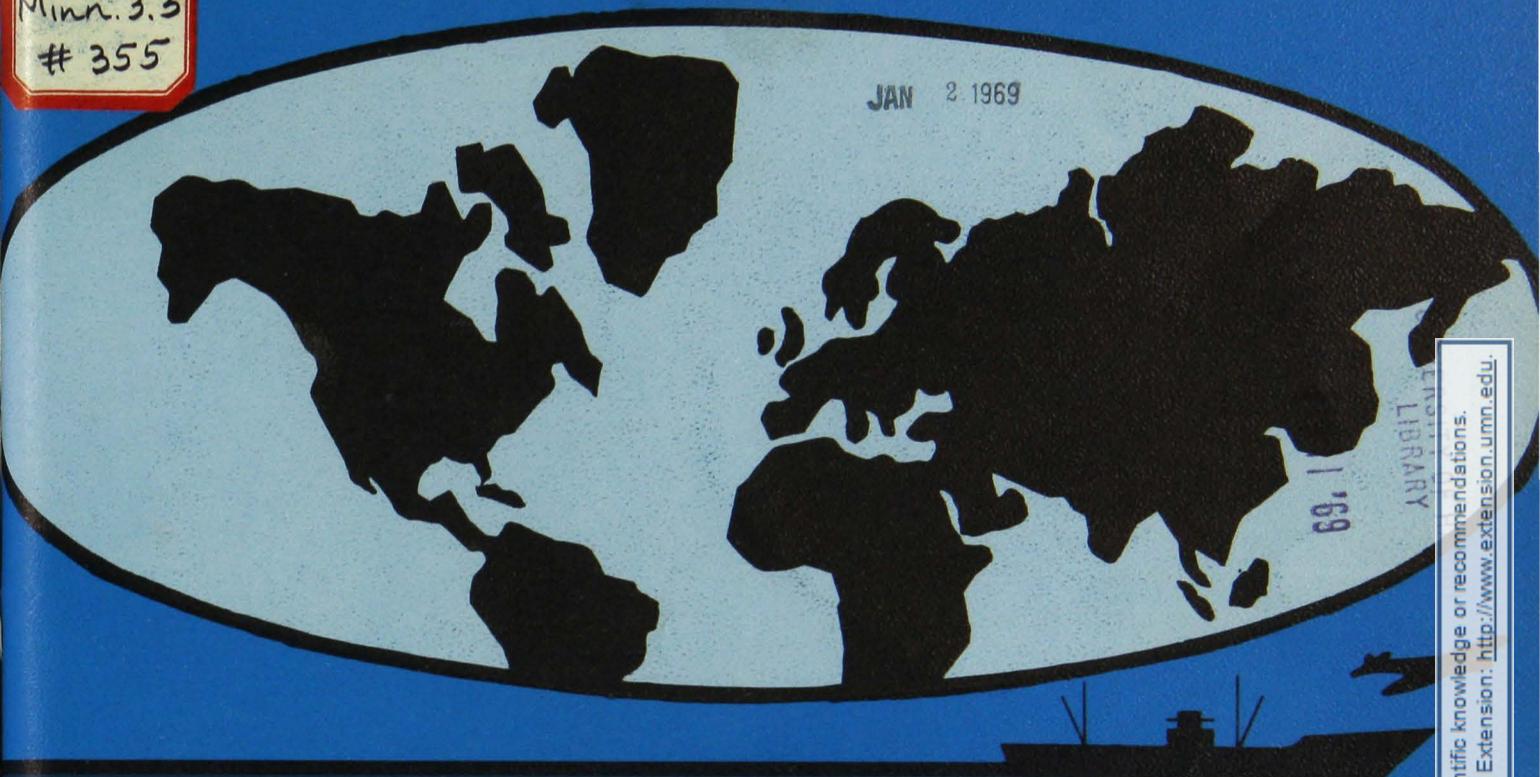


# THE PROTECTIONIST MOOD AND MIDWEST AGRICULTURAL TRADE

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James P. Houck and James G. Ken

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## Preface

U.S. farmers—especially Midwest farmers—depend heavily on foreign markets as outlets for the products they sell. In 1967, nearly \$6.5 billion worth of U.S. agricultural products were exported, and Midwest farmers produced nearly half of those exports. The entire food and fiber sector of our economy has an important stake in the success of public and private efforts to expand world agricultural trade and to eliminate trade restrictions that limit access to foreign markets.

The adage that international trade is a two-way street still is timely. If American farmers and businessmen want to increase sales abroad, they must be willing to allow foreign producers equally free access to U.S. markets. For more than 30 years, the United States has been a world leader in working toward reductions in tariffs, import quotas, and other barriers to world trade. We have benefited significantly from a relaxation of trade barriers, but American sentiment favoring freer world trade has not been universal. New demands now are being made for government action to restrict the flow of foreign goods, both agricultural and industrial, into the United States. A new mood of protectionism and isolationism, which applies to all international affairs of the United States, has appeared on the policy scene.

Opposition to freer world trade is strong in certain segments of U.S. agriculture and industry where foreign imports are considered a threat to the economic well-being of American producers. Stemming from this belief, pressure for import restrictions is understandable. But if new or additional protection is granted, both agriculture and industry in the United States may find their foreign markets curtailed by retaliatory trade barriers imposed by other nations. Any reversal of our longstanding policy in support of freer world trade must be evaluated carefully in terms of probable international economic and political repercussions.

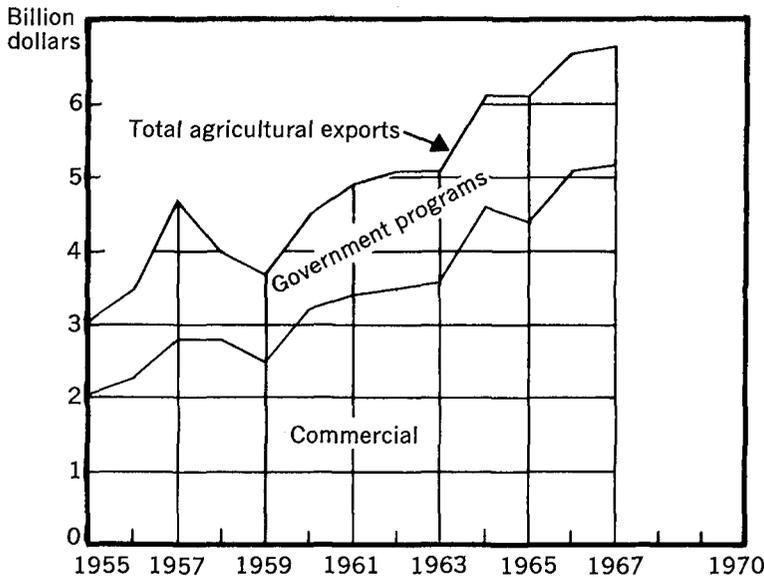
This publication examines arguments for and against a continuation of U.S. policies aimed at securing freer world trade. It gives special attention to present and proposed restrictions against the entry of foreign goods into U.S. markets and the implications of these trade barriers for American agriculture, especially for Midwest agriculture.

The preparation of this publication was sponsored by the North Central Public Affairs Committee and directed by a special subcommittee on agricultural trade. The subcommittee is indebted to the Farm Foundation and to numerous individuals for their assistance. Special recognition is due James P. Houck, associate professor in the Department of Agricultural Economics at the University of Minnesota, and James G. Kendrick, associate professor in the Department of Agricultural Economics at the University of Nebraska, who assumed the responsibilities of authorship.

North Central Public Affairs  
Subcommittee on Agricultural Trade

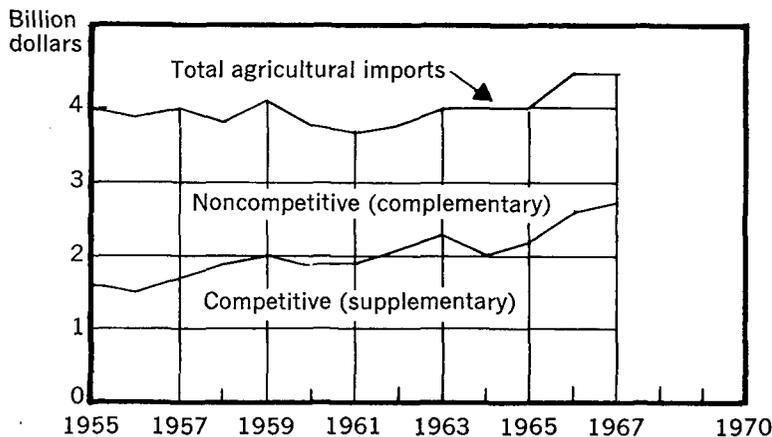
Everett E. Peterson, Chairman  
John O. Dunbar  
Arley D. Waldo





Source: U.S. Department of Agriculture

Figure 1. U.S. agricultural exports: commercial and under government programs, 1955-67



Source: U.S. Department of Agriculture

Figure 2. U.S. agricultural imports: competitive (supplementary) and non-competitive (complementary), 1955-67

About 140 years ago, Lord Macaulay, the British statesman, wrote:

*Free trade, one of the greatest blessings which a government can confer on a people, is in almost every country unpopular.*

While people today might disagree about the advantages of free trade, the idea is still as unpopular. In October 1967, just 3 months after the closing ceremonies for the trade-liberalizing Kennedy Round negotiations, a bundle of new proposals for import restrictions on oil, steel, textiles, meat, dairy products, and other items was placed before the U.S. Senate's Committee on Finance. Hearings and debates on these proposals have since been held and more are expected. The purpose of this report is to explore the mood of protectionism that is creeping back into the attitudes and policy proposals of businessmen, farmers, and their political leaders. To explore it, we will compare the basic principles of free trade with the arguments in favor of more protection from imports. We also will look at the implications of this protectionist phenomenon for the economic health of U.S. agriculture, especially in the Midwest. But first, let's look briefly at the importance of agricultural trade for the nation and the Midwest.

## U.S. Agriculture's Trade Balance: Nationally and in the Midwest

Since 1963, commercial dollar sales of U.S. farm products abroad have been larger than the value of all agricultural imports (figures 1 and 2). Moreover, products such as bananas, coffee, rubber, and tea, which do not compete directly with U.S. farm products in the marketplace, now constitute over 40 percent of the value of agricultural imports.

In 1967, each dollar's worth of **competitive** farm imports (excluding bananas, coffee, tea, etc.) was counterbalanced by about \$2 worth of **commercial** exports. Thus, U.S. farmers have a distinctly favorable "commercial balance of trade." About 12 cents of each gross farm income dollar comes from a cash customer overseas. Yet each dollar's worth of U.S. farm products moving into wholesale markets is joined by only 5 cents worth of imported, competitive items.

The total value of U.S. agricultural exports in 1967 was about twice as large as the value of all farm marketings in Iowa, the Midwest's premier agricultural state.

### **Farm Exports and the Balance of Payments**

In 1967, our commercial merchandise exports of all types (agricultural and nonagricultural) exceeded all imports by only \$19 million. But agriculture's net commercial export balance was \$660 million that year, according to a recent U.S. Department of Agriculture (USDA) report. Agriculture's net export position more than offset the \$641 million net deficit of all nonagricultural trade. Were it not for this position, our international balance of payments problems would be much worse than they are. So, in the aggregate, U.S. agriculture is definitely an export-oriented industry and a very important one in our overall trade picture.

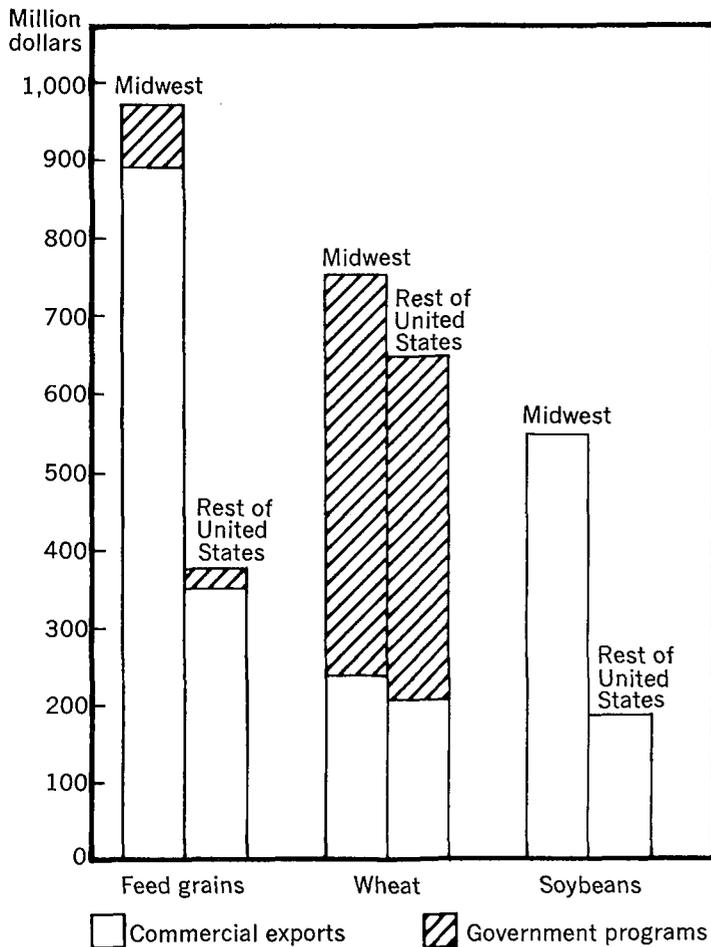
### **Agricultural Imports: Competitive and Noncompetitive**

Americans can be proud that most raw-form noncompetitive agricultural imports enter our ports duty-free. These items—bananas, coffee, cocoa, rubber, tea, and carpet wool, for example—are supplied mainly by the less-developed nations of Latin America, Asia, and Africa. U.S. purchase of these commodities, which were worth about \$1.8 billion in 1967, is vital to the growth and development of many such nations. These imports do not compete directly for markets with domestic products, but they do compete for a place in the budgets of U.S. consumers.

Some competitive farm imports do vie for markets directly with U.S. products. These imported commodities, which were worth about \$2.7 billion in 1967, are subject to a variety of tariffs, quotas, and other import restrictions. Products in this group include sugar, dairy products, meats, and grains. New proposals call for tighter import controls on dairy products, meats, and others. We will look more closely at these proposed restrictions in a later section.

### **The Midwest and Agricultural Trade**

Midwest agriculture is heavily dependent on export sales. Three commodities—wheat, soybeans, and feed grains—together comprise more than half of total U.S. agricultural dollar sales abroad. All of these commodities are produced heavily in the Midwest: Our farmers grow about 55 percent of the wheat, 75 percent of the soybeans, and 80 percent of the total feed grains exported from this country (figure 3). Anything that retards the export flow of these products has a direct impact on the profits and losses of the area's farmers and farm-related businesses. Of the nearly \$6.5 billion worth of U.S. farm exports in 1967, Midwest farmers produced \$3.1 billion worth, or about 48 percent of the total. Nearly \$2.4 billion of these Midwest exports were commercial sales for dollars—sales that would be subject to any new trade



States included in the Midwest: Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin.

Source: U.S. Department of Agriculture

Figure 3. Exports of feed grains, wheat, and soybeans from the Midwest and from the rest of the United States, 1965-66

barriers erected by our foreign customers. Farm income in the Midwest is more dependent upon export sales than the average for the whole nation.

Of course, Midwest farmers also produce some of the same commodities that enter the country from abroad and compete for domestic markets. For instance, about half of our milk output and almost half of our domestic beef output come from the Midwest. These are two major products for which new import controls have been proposed. Imports now represent about 1 percent of our total milk consumption and about 7 percent of all beef and veal consumption.

### Divergent Views on Trade

Although making precise measurements is difficult, the nation's agriculture as a whole and Midwest agriculture in particular clearly have much to lose if world trade in farm products is reduced by a new wave of trade restrictions. Yet there are plausible reasons why some would like the international flow of certain commodities reduced.

If each farmer produced and each firm handled proportional amounts of each exported and imported commodity, all would be in favor of more trade, since U.S. farm exports exceed imports. But specialization in production, processing, and handling divides farmers, their leaders, and their political representatives into numerous factions. It is, for example, hardly surprising that producers of feed grains and soybeans favor freer international trade and fear retaliation from abroad if new U.S. import curbs are enacted. Yet it is equally reasonable to expect beef, dairy, and fruit and vegetable producers to seek import controls against foreign shipments which, they believe, lower their prices and narrow their market opportunities.

## The Rivalry: Freer Trade vs. Protectionism

Through the years, there have been scarcely any public policy issues on which all farmers and their spokesmen agreed. Trade policy is no exception. Let us look at some of the issues and ideas that divide our agricultural interest groups into two rival camps—free traders and protectionists.

### Freer Trade

The basic idea of free trade is that every individual, area, or nation should specialize in what it can produce at the lowest relative cost and then trade with everyone else. In this way, everyone will have more goods and services than if each tries to produce a little of everything. This concept is logically sound and very old. Xenophon, a Greek, wrote in 350 B.C.:

*... inasmuch as many people have demands to make upon each branch of industry, one trade alone is enough to support a man. One man, for instance, makes shoes for men, another for women. And there are places even where one man earns a living by only stitching shoes, another by cutting them out. It follows, therefore, as a matter of course, that he who devotes himself to a very specialized line of work is bound to do it in the best possible manner.*

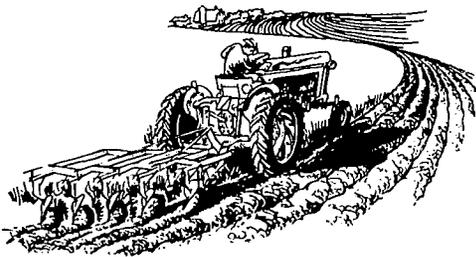
**The Benefits of Specialized Production.** Within the United States, we have followed Xenophon's advice. We specialize. The Plains States produce most of our wheat, California and Florida produce our oranges and grapefruit, the Corn Belt produces feed grains and feeds much of our livestock. Each specializes in the products which, through a combination of labor, land, and markets, can be produced more economically in that region than in others.

However, specialization fosters a problem. Each area produces much more of some products than it can use and produces few, if any, of the other products it needs. Obviously, trade between specialized production areas must take place. Then each area can obtain a variety of products and pay for them with its surplus production.

These ideas suggest two major principles of trade: (1) Each area should specialize in products for which it has low relative costs compared to the other things it might produce and (2) Each area should trade with other areas so that consumers in all areas can obtain goods produced at the lowest costs.

One reason why most U.S. citizens enjoy a high standard of living materially is that free trade is carried on between the states. In fact, our Constitution contains a specific section prohibiting any trade barriers between states. A similar provision was written into the Commonwealth Constitution of Australia, insuring free trade between that nation's states.

**Trade Between Nations.** The argument for free trade between nations is the same as that for free trade between areas of a country. By permitting each nation to specialize in those items for which it has a relative cost advantage and by encouraging trade between nations, the citizens of all nations achieve higher standards of living. In fact, any barriers that inhibit the free exchange



of goods between nations or areas will, in the long run, reduce everyone's level of living by raising prices and inhibiting national growth rates.

## Protectionism

What is protectionism in the economic sense? Broadly speaking, protectionism occurs when, through economic policies, any group of buyers or sellers deliberately insulates itself from the full force of competitive pressures. Although protectionism and protectionist policies usually are identified with a nation's foreign trade activity, any group can be deliberately protected. For example, dairy farmers in the eastern United States may be protected from midwestern milk competition by arbitrary health or sanitary regulations in much the same way as all dairymen are protected from foreign competition via our import quotas on cheese, butter, cream, and other dairy products. A labor union may protect its members from nonunion competition for available jobs by insisting on closed shop contracts with employers. Similarly, all workers in a nation may be protected from job-seeking foreigners by means of tight immigration controls. Consumers in a region or a nation can be protected from competition from outside buyers who bid for available supplies and thereby force prices up. Export taxes or embargoes (prohibitions) can keep prices inside a region or a nation lower than they otherwise would be.

Most people think of protectionism as national policies and programs that reduce the **imports** of foreign goods below the amount that otherwise would enter the domestic market. The result of these actions is to reduce competitive pressure on domestic producers of the same or similar items. This is the sense in which we will use the term. We should recognize, however, that **export** assistance through subsidies and other means is a form of protectionism in favor of exporters.

The classic method of protection is a tariff, sometimes called an import tax or a duty. It is either a fixed tax per unit imported or a fixed percentage of the value of each shipment.

We have taxed imports from our earliest days as an independent nation. Our first tariffs were used mainly to raise government funds. As other more comprehensive means of raising government revenue were found, the tariff system evolved into a mechanism for protecting U.S. farmers and manufacturers from the full force of foreign competition. Today, tariffs amount to just a little over 1 percent of all U.S. government revenue.

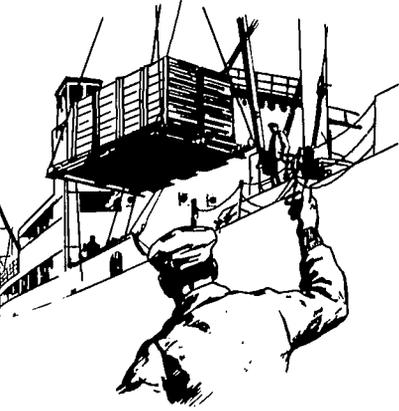
In recent decades, other nontariff protection tools have been forged. These include government-controlled quotas, mixing regulations, packaging and labeling requirements, foreign exchange restrictions, and, more recently, variable import levies.\* All of these devices have at least one thing in common: They make it difficult or even impossible for foreign sellers to compete with domestic sellers in a given **national market**. Virtually all nations, including the United States, apply some of these protectionist measures at their borders.

## Reasons for Protection

Why does pressure for protection from imports develop? What causes farmers, businessmen, and political leaders to call for government-sponsored

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\*For definitions of these and other common trade terms, see the glossary on page 26.



import protection when the same individuals might oppose other federal interference in the marketplace? The major reasons are:

- (1) To protect national security.
- (2) To protect national health.
- (3) To offset "unfair" trade policies of other countries.
- (4) To protect existing economic policies and programs.
- (5) To protect a struggling new industry.
- (6) To improve the international balance of payments.
- (7) To avoid or diminish painful economic adjustments within an industry.

These categories are closely interrelated. A protective policy measure advanced on one of these grounds may have its real roots in others. But let us consider each as if it could be separated.

**Protect National Security.** The principles of international trade suggest that nations with low production costs for a particular product or industry will be exporters and nations with higher costs will be importers. Specialization will continue as resources flow out of an industry in the relatively high-cost nations and into that industry in the relatively low-cost ones. Trade will expand. From the importer's point of view, this tendency toward international specialization might force a particular domestic industry to shrink below levels considered prudent for political and social reasons.

In times of international distress or actual war, trade usually shrinks or stops entirely. If nation A were dependent upon nation B for the weapons of war, then A would be particularly vulnerable during time of war, especially if B were its enemy. Many nations maintain industries that produce the essentials of war—food and weapons—even though the principles of free trade dictate otherwise. Maintaining industries that are not economically efficient reduces a nation's level of living. However, if such a nation would cease to exist in the event of war, then the citizens of that nation might willingly support industrial production that is thought to be essential to national defense. The essential industry classification may include certain agricultural products, oil, steel, watches, aircrafts, and electronics.

Many European nations are substantial food importers. Some would be even larger food importers if full international specialization in food production were followed. But most of these countries cling to some minimum level of self-sufficiency, at least partially for national security reasons. Bitter past experiences with food shortages caused by trade disruption and the destruction of war underpin this desire.

Part of the justification for the current U.S. protection of domestic sugar and wool producers hinges on the belief that these commodities are strategic for national security. A commodity-by-commodity approach to strategic goods is slightly different from an overall national commitment to maintain a country's farm industry at some minimal size. However, where the latter policy exists, it usually includes commodity-by-commodity trade restrictions.

If a particular industry is truly essential to national security and survival, the argument for raising protective trade barriers is strong. The difficulty

arises in determining which industries are so essential that their absence jeopardizes the nation in wartime even though their protection lowers national living standards during peacetime.

**Protect National Health.** The free trade of goods between nations may be prohibited for health reasons. The United States prohibits the importation of fresh or frozen beef from many countries that have a history of foot-and-mouth disease. Likewise, some nations restrict imports of U.S. frozen poultry, fearing infection of their flocks with Newcastle disease. In some countries, metropolitan areas do not permit fluid milk to be sold within their jurisdiction unless the dairy farms, whether domestic or foreign, have been approved by their own inspectors.

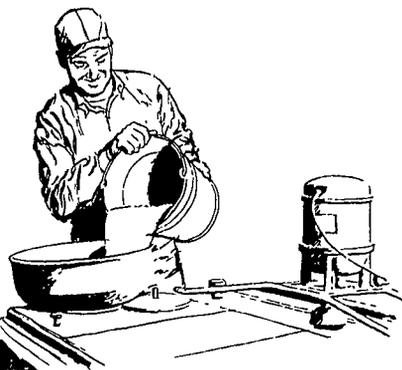
Clearly, governments are wise to regulate trade in products that might be injurious to public health. Unfortunately, the health argument sometimes is used to prevent trade that in reality is threatening the economic health of an industry. Such limitations raise prices and protect the incomes of a few producers. Trade restraints established for legitimate health reasons should be re-examined periodically to determine whether or not the health hazard still exists.

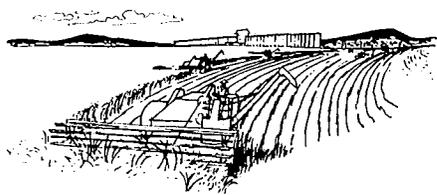
**Offset "Unfair" Policies of Others.** Most trading nations can use a number of measures to restrict imports of competitive goods when they feel that exporting nations are dumping excess production into international markets. When exporters attempt to dispose of surplus production or capture new foreign markets, a favorite technique is to offer the goods at prices lower than internal levels. Export subsidies and multiple price schemes often are employed in this effort. The United States operates several such programs. Special credit arrangements or related price concessions on other export items may be used along with an export subsidy.

Consumers in importing nations typically favor the purchase of world market goods offered at low prices if the price decreases are passed along to them. However, producer groups and domestic merchants often are successful in obtaining countervailing duties, quotas, and special restrictions to offset the "unfair" price advantage of foreign sellers who offer goods at prices below production costs or under special sale terms.

The United States uses a number of such protective measures. We have legal provisions to exclude from entry into this country any commodity for which an "unfair trade practice" has been established. Countervailing duties can be placed upon goods subject to direct or indirect production or export subsidy. As amended, the Antidumping Act of 1921 permits additional duties to be levied when foreign goods are being sold (or are likely to be sold) at "less than fair value." The fuzziness of terms such as unfair trade practice, production or export subsidy, and fair value make these regulations difficult to apply in any but the most obvious situations.

**Protect Domestic Programs.** When a government supports the market price of any commodity above world levels, some form of import control usually is required to prevent the program from being swamped by goods from abroad. This is an especially difficult problem for many western trading nations that provide income support to farmers through high guaranteed prices.





When a national program is established to raise market prices above equilibrium or world levels, the amount supplied to that national market, whether from domestic or foreign sources, normally will exceed the amount demanded for consumption. Unless the government operating the program has an infinitely large storage capacity or a bottomless treasury, some means of controlling supplies offered for sale at the support price must be found. The first action usually is taken against imports. By cutting off or reducing imports, it may be possible to bring demand and supply into balance at the support price without resorting to unpopular production controls on domestic producers. But even if some form of internal production adjustment is used, import controls still are needed to keep the program from being inundated from abroad. When market prices are supported above world levels by government action, import controls must be available.

Both the European Economic Community (EEC) and the United States offer good examples of this type of protectionism. Much of the EEC's support of farm income is channeled through the price system. (Incidentally, introduction of this type of protection was the only way a mutually-agreeable six-nation common farm policy could be forged.) Since the EEC is a large net importer of many basic agricultural commodities, highly unpopular production controls were not thought necessary. Imports of these basic commodities are controlled by means of a variable import levy system that raises prices of imported goods up to the level of supported domestic prices. Consequently, most of the adjustment between larger domestic output and lower or constant domestic consumption is borne by countries exporting to the EEC in the form of smaller markets or slower market growth than otherwise would exist.

Since the thirties, our government has supported farm income mainly through price supports. These supports have been applied to storable commodities such as wheat, feed grains, cotton, and tobacco. These are commodities we export and probably would continue to export even at lower price levels. So, to prevent supplies from abroad from flowing into the higher-priced U.S. market, strict import quotas and levies are applied to price-supported products under authority of Section 22 of the Agricultural Adjustment Act, as amended in 1935. The purpose of these quotas is **not** to protect domestic producers directly or to raise domestic prices over world levels. It is to protect the government's price support programs and to insure that the U.S. Treasury does not have to support prices for the whole world. Section 22 states that imports are not to "render ineffective, tend to render ineffective or materially interfere with any program or operation undertaken" under the Agricultural Adjustment Act. This provision authorizes the President, after an investigation by the U.S. Tariff Commission, to prevent such interference by establishing import quotas or levies on affected commodities.

**Protect a New Industry.** Trade restrictions sometimes are used to protect new industries. For example, suppose that nation A does not produce cotton, but buys it from nation B. Cost studies show that if A attempted to produce its own cotton, the cost would be higher than B's cotton price. However, studies also show that A's cost disadvantage is only a short-term problem. If A somehow could begin cotton production, it could in time be just as efficient or perhaps more efficient than B. But time and money are required to

construct efficient irrigation facilities, train producers, procure specialized equipment, etc. To enable A to get into cotton production, a tariff might be added to the price of cotton imports from B so that producers in A could begin to compete in the local market. In reality, the consumers of nation A would be forced to pay a subsidy to their cotton producers in the hope that someday the new industry would be efficient. Economists call this the infant industry argument for protection.

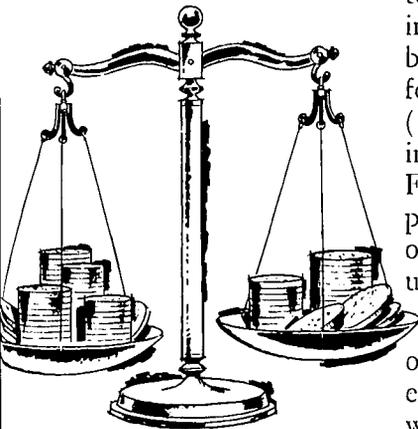
A concrete problem is that if a fledgling industry has the political power to obtain a protective tariff, it often has the political power to prevent its removal. When this occurs, the infant never grows up and consumers find that their level of living has been permanently reduced to protect incomes in the favored industry.

**Improve the Balance of Payments.** When a nation's payments to foreigners persistently exceed its earnings from them, the country has balance of payments problems. When balance of payments difficulties continue for a long time, international confidence in a nation's currency and economic strength likely will be undermined. Downward pressures will develop on the value of the nation's currency relative to other currencies.

To avoid such problems, a government may attempt to reduce payments to foreigners by restricting the entry of imported goods. If the nation's earnings from exports remain the same, the reduction of imports will tend to bring the nation's international payments account into balance. However, foreign earnings may not stay the same. They may decrease for two reasons: (1) Foreigners will be earning less of the restricting nation's currency from imports and hence may buy less, turning instead to other suppliers and (2) Foreign governments may retaliate by raising their own trade barriers toward products shipped from the restricting nation. Restricting imports is not the only way nations attempt to solve balance of payments problems, but it usually is one of the first remedies attempted.

**Avoid Painful Economic Adjustment.** A sharp increase in the importation of some item that competes with domestic production often is a signal for economic adjustments. If the increased import flow and the resulting downward pressure on domestic prices and sales are not caused by deliberate temporary dumping by foreign sellers, some domestic producers probably will be forced to leave the industry or to accept lower returns. For the people involved, this often is a difficult and painful choice. For resources like highly specialized buildings and equipment, there may be no choice.

It is therefore not at all surprising that industry leaders and their representatives turn first to governmental control of imports—to protectionism—when imports threaten traditional domestic markets. Such threats constitute the most important reason for the current protectionist sentiment in the United States. Although other rationalizations may be stressed, the desire to avoid harsh economic adjustments usually lies behind the drive for import controls. This desire is especially true of the agricultural sector of many trading nations, including the United States. In agriculture, resources historically are less mobile than elsewhere in the economy. Moreover, powerful economic and technical changes quite apart from foreign competition already are forcing massive adjustments within the sector.



Simply to accuse adversely-affected groups of selfishness and shortsightedness when they attack competitive imports by proposing higher tariffs and tighter quotas is to be naive about the actual processes of competition and economic adjustment. Industry jobs lost due to import competition are not always similar to those that open up in other industries nor are they necessarily located in the same area. Highly specialized machinery, buildings, tools, and other facilities may be rooted permanently in the affected industry. They will continue to be used even at low returns until they simply wear out or until their value in use becomes less than their salvage value. But to protect an industry from onerous resource adjustments is to sustain longrun costs and consequences elsewhere in the economy.

## The Consequences of Protection

When a domestic industry or commodity group succeeds in obtaining an increase in protection through a tariff increase or a tighter quota, the general public in that nation must be prepared to face one or more economic consequences. No matter what the reasons behind the protective action, economic effects will be felt within the nation and internationally.

### Internal Effects

As pressure from competitive imports is reduced, the price of the protected product, in most cases, will be higher than it otherwise would be. Furthermore, product prices in industries that use the protected item or similar protected resources also will be higher. Some of these may be export industries that must compete internationally. In addition, the range of choices available to buyers may be narrowed substantially if the imported items have attributes different from those of domestic products.

Once an industry or commodity group gains even a modest protective umbrella, pressures to increase that protection can become virtually irresistible as foreign productive efficiency improves. Suppose that an industry initially obtains protection with a 5 percent tariff rate. This rate may be sufficient to keep the domestic industry well in control of total sales; new resources may even flow into production. But then suppose that foreign productivity surges ahead dramatically so that even with the 5 percent tariff, imports can be sold substantially cheaper than domestic items. The pressure to increase the tariff will mount and domestic distress will be keen. The initial tariff protection sheltered the resources in that industry from foreign competition. Policymakers will have to ask themselves if it is fair to subject these resources to the full blast of foreign competition after an earlier policy placed them in a protected position. Thus, another consequence of new protection is to increase the chances that further protective measures will be required to maintain the initial policy objectives.

Reducing the hardships of increased foreign competition can cost tax dollars through programs of worker retraining and tax incentives to stimulate capital flows out of the affected sector. But supporting an inefficient industry through trade barriers will cost many more consumer dollars in the form of higher prices. For the nation as a whole, it may be better to spend funds for adjustment assistance than to force buyers to pay higher prices forever.

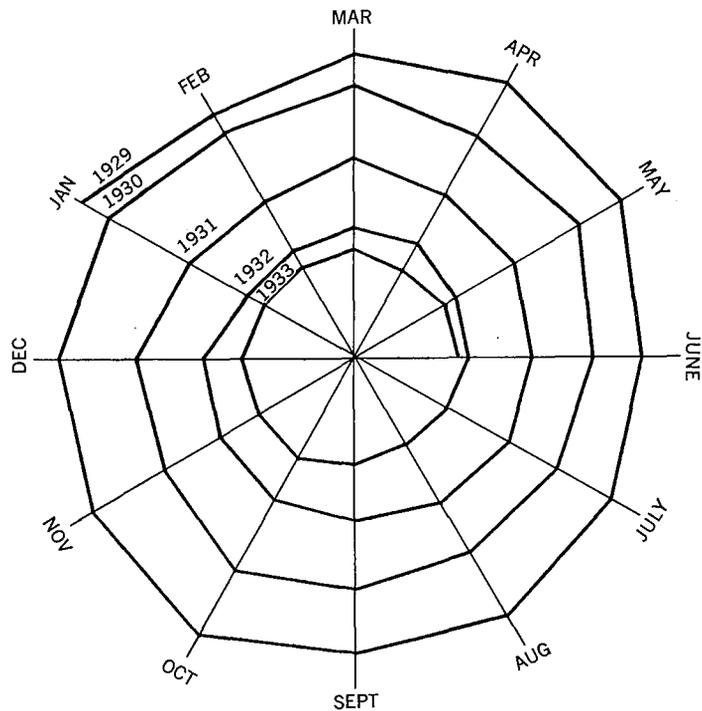


Figure 4. The contracting spiral of world trade (Source: League of Nations, "World Economic Study, 1932-3," Geneva, 1933, page 8)

Of course, added protection for a single commodity or small industry may not produce a measurable drag on the total economy, but the tendency is there nonetheless. By discouraging the flow of existing and new resources into more efficient pursuits, protection in a few sectors can slow down overall economic growth. And when multiplied by many industries in many sectors, the impact can be profound.

The general public actually subsidizes protected industries. Though citizens may be willing to do so for strategic or welfare reasons, they still should be aware of it. A simple test of the acceptability of a proposed increase in protection would be to ask citizens whether or not they would be willing to pay an equivalent subsidy directly to an industry by means of higher taxes. The results of such a poll might be enlightening.

### External Consequences

Perhaps the most dramatic consequence of increasing protection is that foreign nations usually retaliate by increasing their tariffs and other trade barriers against the products of the protecting nation. One reason that world trade volume declined almost 50 percent in the early thirties was that depression-induced tariff increases in the United States were met by retaliatory tariff hikes in other nations. Their hikes led to another round of tariff increases and more retaliation. This action and reaction intensified and prolonged the worldwide slump in economic activity. The downward spiral in trade almost strangled world commerce and contributed to international distrust prior to World War II (figure 4).

Today, many of our foreign customers, especially those in Western Europe, already operate complex nontariff trade restrictions that limit our potential export volume. They do it mainly to protect their own farmers from international competition. It would take only a modest tightening of these restrictions to cut deeply into U.S. farm exports.

When one nation retaliates against another, the burden of the reprisal falls on industries and sectors other than the one that gains the initial protection. Unfortunately, the protecting nation cannot select the sectors that will take the counterblow: That is left to the discretion of the retaliator. But the revenge will fall on export industries that generally are among the most efficient in the country. So more jobs may be lost and more resources idled from the retaliatory effects than were sustained by the protection.

### **Reducing Protection Internationally**

The longrun result of protectionism is to reduce living levels, subsidize inefficient industries, and punish the most efficient. For these reasons, trading nations have worked toward trade barrier reduction for more than 30 years.

The General Agreement on Tariffs and Trade (GATT) was established at the end of World War II with 23 member countries, including the United States. Its basic purpose was to assist in the renovation of war-shattered and tariff-burdened world commerce by establishing fundamental ground rules for international trade policy and negotiation. GATT, which now has about 70 members, has negotiated a deliberate step-by-step relaxation of many trade barriers since 1948. Most of the agreements have been achieved through the mutual exchange of offsetting tariff concessions, nation-by-nation and commodity-by-commodity.

The current pattern of trade relationships is by no means perfect, especially in agricultural trade. But there is more and freer trade than there would have been without GATT. The established pattern is a delicate balance of agreement among nations. Unilateral action by a single nation to upset the balance by adopting, for example, a new and tighter set of import quotas could set off retaliation and counter-retaliation that could unravel much of this carefully-woven fabric of liberalized trade. The resulting decline in trade volume could easily slow down overall growth rates and lead to reduced incomes in many nations, including the United States. We now display a small excess of merchandise exports over imports, but we also face a serious balance of payments problem. Any narrowing of our current net export position will mean added strain on our international financial strength. And, as we have seen, these net exports are especially important in the agricultural trade sector.

## **U.S. Tariff Levels and Agricultural Trade Restrictions**

Until World War II, average tariff levels in the United States rose and fell as the political power of protectionist factions here and abroad waxed and waned. Tariff peaks were reached in 1830, 1865, and 1933. The Smoot-Hawley Tariff Act of 1930 led to the most recent high water mark in U.S.



tariffs, but tariff levels throughout the world have drifted downward since the thirties. The turning point was the passage of the U.S. Reciprocal Trade Agreements Act of 1934. This measure gave the President authority to negotiate tariff concessions on imports in return for equivalent concessions on U.S. exports in foreign markets. The act and its subsequent amendments and revisions have permitted us to participate in GATT and other tariff negotiations.

Agricultural trade has not been affected by tariff cuts to the same extent as nonagricultural trade. Simple fixed or percentage tariffs are not the keystones of agricultural protection for most trading nations. Quotas, other quantitative restrictions, export subsidies, and variable import levies are the measures widely used. These instruments generally reflect the overall protection extended to a nation's farmers by their government. Nations attack problems of lagging farm income, price and income instability, and excess productive capacity with a variety of policy measures, of which import control is only one. Agricultural trade restrictions, which have grown up in the past 30-40 years, are extremely difficult to negotiate internationally, since they are the extension of complex domestic agricultural policies. Negotiation of these trade impediments implies negotiation of domestic agricultural policies and price levels—a difficult and thus far impossible task. Although some efforts have been made, almost no real progress has been made on this front in recent trade negotiations.

### **The Trade Expansion Act of 1962 and the Kennedy Round**

During the early sixties, supporters of liberalized trade held the spotlight as President John F. Kennedy's Trade Expansion Act of 1962 won congressional approval. Among other things, this bill gave the administration authority to participate in the sixth major negotiating session of GATT. This session, entitled the Kennedy Round, began in Geneva, Switzerland, in 1964. At the beginning of the Kennedy Round talks, hopes were high that wide-ranging agreements on industrial and agricultural protection that would stimulate mutually-beneficial expansion in international commerce could be reached.

Our participation in these negotiations was consistent with our long-term commitment to freer international trade. To be sure, the U.S. record as a liberal trade force is not unblemished; our policies and behavior are not always fully consistent. Strong protectionist forces in both our agriculture and our industry have managed to blunt the force of international competition in some commodities and sectors, and our system of farm price supports for many basic commodities has made strict import control of supported items unavoidable. Yet, on the whole, the United States must be considered a leading supporter of liberal trade among the world's major commercial nations. As the Secretary of State recently observed, "For 33 years it has been the policy of the United States to lower, on the basis of reciprocity, barriers to international trade. This policy has served the nation well."

After much initial activity, the Kennedy Round talks stalled and remained deadlocked for many months because of three closely related factors: (1) Agreements concerning many industrial products had to be put aside until reciprocal or off-setting agreements on farm products could be concluded, (2) Agreements on agricultural products could not be reached for some time because the EEC had not yet agreed on internal price levels for its own six-nation agricultural policy, and (3) Even after the EEC's common agricultural policy was settled, the differences in basic negotiating positions on agricultural trade were too wide to bridge.

With the July 1967 deadline approaching fast, marathon negotiating sessions were conducted to salvage whatever agreements were possible, given the breach between the major participants' positions on agriculture. Broadly speaking, the United States wanted concrete prior agreements on market access and import shares within the EEC. The EEC, meanwhile, insisted on maintaining its variable import levy system. It proposed extension of the levy mechanism to world trade in basic agricultural products. Its view was that the "margin of support" given farmers in major trading nations then could be measured and negotiated.

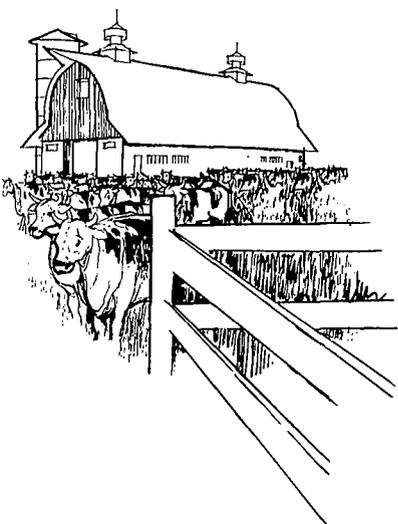
Even though clocks in the negotiating chamber were stopped so that the official deadlines would not pass while progress was being made, the agricultural agreements that finally emerged were disappointing to many. Some lowering of agricultural tariffs was achieved, and a modest international grains arrangement was concluded. For U.S. agricultural interests, the Kennedy Round, while not a failure, still did not produce the hoped-for agreements on nontariff trade barriers.

### **The Protectionist Mood**

As the Kennedy Round concluded, new stirrings of protectionism were being felt throughout the U.S. economy, in the farm and industrial sectors as well as in Congress. In the first place, numerous proposals for more import control began to surface. They had been submerged in legislative committees and elsewhere while the negotiations were in full swing. Second, the apparent lack of notable progress in the negotiations had disillusioned many lukewarm liberal trade supporters. Third, some unilateral trade restricting moves had been made by several foreign nations with whom we trade. Finally, the political makeup of Congress had become more conservative since the passage of the 1962 act.

The protectionist mood in parts of the agricultural economy was intensified by the 10 percent drop in net farm income during 1967, part of which was blamed on import competition. A USDA official recently called this sentiment "neo-isolationism." By this, he meant a revival of the view that the United States should withdraw from many of its economic and political commitments around the world.

Against this background, the U.S. Senate Committee on Finance held a 3-day series of hearings in October 1967 on a collection of proposed import quota bills. The major proposals included new quota restrictions on oil, steel, lead, zinc, and textiles in the industrial sector and meat and dairy products in the agricultural sector.



## The Agricultural Quota Proposals

There are several similar versions of each quota proposal for both meat and dairy products. But since the two situations involve different problems, let us look at each one briefly. The textile quota proposal is not discussed, although this proposal does affect the farm sector, especially in cotton-growing areas.

### Meat Imports

Cattlemen have long argued that much of the instability and periodic low prices in their industry are the direct results of lean beef imports, primarily from Australia. Imported beef is used mainly in hamburger and processed meat products. Import supplies have ranged from 6 to 10 percent of domestic beef production since 1960, peaking at 10 percent in 1963. Imports are a small portion of total U.S. meat consumption, averaging 5 percent over the past 8 years.

**The Meat Import Law.** After the large increase in meat imports in 1963, a voluntary import control agreement was concluded with our major beef suppliers to avoid extreme industry pressure for tight import controls. This agreement was superseded by the meat import law of 1964 (Public Law 88-482). This law does not actually impose direct quotas: It sets an annual import target based on domestic production of beef, veal, mutton, and goat. The import target is the average annual quantity of these items imported in the 1959-63 period increased or decreased by the same percentage as domestic production has increased or decreased from the same 5-year period.

When prospective imports, as estimated by the Secretary of Agriculture, equal or exceed 110 percent of the target, quotas that will hold actual imported quantities to the target amount are to be imposed. As of mid-1968, imported meat volume had not been large enough to trigger the quota apparatus. It has been argued, however, that the very existence of the law has induced foreign meat exporters to hold back shipments that otherwise might have been made.

The newly proposed quota measures have three major features that would enhance the restrictive character of the law. First, the 5-year period on which target quantities are based would be changed to the 1958-62 period. This change would drop the large import year of 1963 and add the small import year of 1958. The base import quantity would be sharply reduced (by about 20 percent), thereby reducing the import target. Second, this smaller annual import target would be apportioned into quarterly quotas, unfilled portions of which could not be carried over into subsequent quarters. Third, the 10 percent override provision in the current law would be eliminated. Instead, quotas would be triggered whenever prospective imports threatened to go above the actual target level rather than when they reached 110 percent of it.

**Price and Trade Effects.** Testifying at the October 1967 hearings, the Secretary of Agriculture said that if the most protectionistic features of the proposed bills were enacted, domestic cattle prices would increase only 1.5-3.5 percent. Most of this modest increase would be for domestic canner and cutter beef (slaughter cows and culled dairy cows). Little would be for fed beef, because almost all imported beef competes directly with the nonfed, lean beef produced in this country. U.S. demand for this type of beef has grown rapidly, but the decline in dairy herds has cut into the supply, opening up an attractive market for importers.

Australian officials have hinted that retaliation against U.S. exports can be expected if meat quotas are tightened. The retaliation might come in the form of withdrawal of concessions negotiated in the Kennedy Round.

### **Dairy Imports**

Dairy producers are in trouble throughout the world. Slowly increasing demand and rapidly expanding supplies have exerted strong downward pressures on dairy prices and incomes. Protective programs in behalf of dairy farmers have resulted in dairy surpluses around the globe, so storage programs and export subsidy schemes are commonplace. Dairy imports are controlled in most countries, including the United States, and no commodity policy problem in U.S. agriculture has proved more difficult.

**Dairy Import Quotas.** The federal government supports the entire price structure of dairy products by supporting the price of manufacturing grade milk. When necessary, manufacturing milk prices are supported by government purchases of basic manufactured dairy products—butter, nonfat dry milk, etc. To prevent international dairy supplies from seeking the supported U.S. price, import quotas on rigidly-defined products have been imposed under Section 22 of the Agricultural Adjustment Act. As mentioned previously, these quotas are invoked to protect the federal price support mechanism. They worked reasonably well, in terms of their objectives, until the mid-sixties. However, like cattlemen, dairy producers have long blamed imports for at least part of their price and income problem.

Imports of dairy products into the United States jumped sensationally from about 1 percent of nonfluid milk utilization in 1965 to over 4 percent in 1966. They threatened to go even higher in 1967. The reasons were:

1. Prices in the U.S. dairy sector were up in 1966 as domestic milk production dropped for the second straight year. The overall support rate for manufacturing milk was increased from \$3.24 per hundred-weight (cwt.) in 1965 to \$4 per cwt. in 1966.
2. Dairy surpluses in Europe and elsewhere prompted some foreign governments to adopt dairy export subsidy programs.
3. Technological developments in dairy manufacturing and handling made it feasible for importers to formulate and ship products to the United States which did not conform precisely to the rigid Section 22 quota descriptions, but which did compete directly with quota items. In 1966-67, much import growth was in the nonquota butterfat-sugar mixtures used in ice cream and in several nonquota cheese products.

In mid-1967, dairy price support purchases began to grow. Upon the advice of the Secretary of Agriculture and after an investigation by the Tariff Commission, the President issued Presidential Proclamation 3790 under the authority of Section 22. This proclamation closed some loopholes in the quota structure and fixed the maximum import volume at about 1 billion milk-equivalent pounds annually. This amount is about 1.5 percent of the current annual U.S. nonfluid milk utilization and about one-fourth of the predicted 1967 imports if action had not been taken.

Most of the new dairy quota proposals are similar. They require that blanket import controls on all dairy products be imposed by specific legislation rather than through the administration of Section 22. The quotas would therefore be permanent: They could be changed only through new legislation—a lengthy and difficult process.

Foreigners are not so much concerned that new dairy quotas would be more restrictive than current Section 22 controls. They probably would not be. But the precedent-setting character of legislative quotas would be dangerous from their point of view. Such restrictions would indicate a major change in basic U.S. trade policy, especially if they were enacted jointly with new meat quotas and quotas on nonagricultural products.

**The Price Effects.** The price effect on manufacturing milk directly attributable to reducing imports from 1966-67 levels has been estimated as an increase of about 5 percent, with no decrease in government purchases. Any production response to this price increase certainly will offset part of it. Actual market prices also reflect the impact of other factors, but the net shortrun price effect of import curtailment is approximately 5 percent.

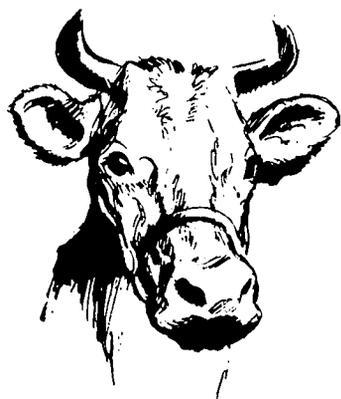
In the short run, the price-enhancing effect of snuffing out imports is exactly the same as withdrawing an equal amount from domestic production. The price increase hinges on reduction of market supplies no matter what the source of reduction. In the long run, an important issue is the speed with which imports respond to higher U.S. prices if imports are permitted entry or the speed with which U.S. production responds to higher prices if imports are held down. In either case, increased supplies soon will cancel out some of the price rise.

When manufacturing milk prices are resting on the support level, any cutback in imports first will show up as a decrease in government support purchases under current policies. Price increases due to stricter import quotas will occur only if support purchases are more than offset by a reduction in supplies permitted entry.

Whether or not dairy farmers or livestock producers will be better off as a result of import cuts is still an open question. A small price boost may delay inevitable adjustments for inefficient operators, but it will not save them. And the risks of retaliation for the nation as a whole and for Midwest agriculture in particular probably are substantial, though difficult to measure.

### **The Quota Package**

Any single quota proposal probably could not achieve broad enough political support to insure its enactment. The only direct beneficiaries are



those in and closely related to the protected industry. But if, as many advocates of freer trade fear, the protectionist forces join together, a combined package of import quotas might well win passage. Such a maneuver has been called the “Christmas tree” approach—there’s something on it for everyone.

None of the **individual** quota proposals would cover more than a small fraction of our total import volume. For example, new restrictions on oil imports, by far the most important item, would affect only about 8 percent of all current U.S. merchandise imports. However, if strung together, these quotas would amount to a reversal of the trade and commercial policy our country has slowly and painstakingly developed since the Depression and World War II. The trading of political support for individually-attractive sections of an omnibus quota bill could easily result in a fundamental trade policy shift for this country. If U.S. citizens and legislators wish to repudiate past and current trade policies, they should be fully aware of what they are changing and of the potential consequences.

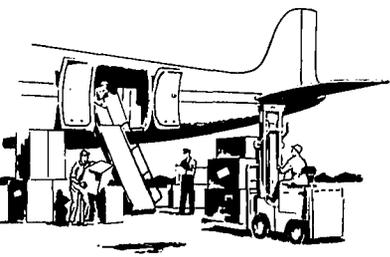
The United States has been a strong supporter of GATT from the very beginning. One of the basic principles of this international agreement is that import quotas are not to be condoned as acceptable trade policy devices except in very special situations. Removing existing quotas among trading nations has been difficult and not particularly successful up to the present. But an endorsement of the quota principle by Congress and a sizable segment of U.S. industry and agriculture would place the United States in direct opposition to the spirit of GATT and could undermine our prestige in future trade discussions and negotiations. If legislative import quotas had been in effect in the thirties, very few of the relaxations in foreign trade barriers that we have negotiated in the past 30 years would have been possible.

## The Policy Alternatives

One alternative is to permit the enactment of the Christmas tree quota package or some part of it. These consequences could be expected: Producers of the protected items would be more assured of their domestic markets; their incomes would be higher but at the expense of higher consumer prices. Our self-sufficiency in these products would be enhanced. Our export industries, both agricultural and industrial, would have to take their chances on the extent and severity of the retaliation undertaken by nations that import from us. Foreigners would be earning fewer dollars from their imports and could be expected to cut down their purchases from our export industries. Some decline or at least a slower growth rate in international trade undoubtedly would occur. Our ability to negotiate future concessions on trade barriers for our exports surely would be impaired, and our international reputation as a supporter of freer trade among all nations would be damaged.

But suppose we agree that new import quotas are not in the overall national interest or in agriculture’s interest generally. What policy alternatives could be used to deal with the economic pressures that would result from increasing foreign competition?

A first step might be to provide adequate resources for careful investigation of import injury claims. Imports often are only incidental to other funda-



mental economic problems afflicting an industry or a sector. When a group of producers or manufacturers finds itself in difficult economic straits, the first defense usually is to seek relief from competitive imports. Import restriction can be the easiest and quickest means of delaying or avoiding necessary resource adjustments. Although current policy provides for such investigation by the Tariff Commission under certain circumstances, the results are not binding upon the administration or the Congress. Furthermore, the Tariff Commission often does not have the time or personnel available for complete investigations.

When investigation shows that a particular industry has been injured by imports and that the injury is the result of dumping or distress selling by other nations, offsetting tariff measures should be available. Our Antidumping Act and similar devices provide for such circumstances. The ambiguity and lack of clarity built into these measures could be removed so they could be applied more quickly, more fairly, and with more precision than they now are.

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When investigation shows that a particular industry has been injured by imports and that the increased imports occurred because we lowered previous trade barriers, the case for providing adjustment assistance is strong. Adequate financial, educational, and other assistance could be made available for resource adjustment, retraining, and relocation when affected resources, especially human resources, are not fully mobile. Such assistance was possible under the Trade Expansion Act of 1962. Its coverage and scope could be improved and broadened.

When investigation shows that an industry or a sector has been injured by imports and that the increased imports are the result of shifts in basic world demand and supply conditions, the policy choices are difficult. We might ask why industries threatened by imports in this situation should have access to special treatment that is unavailable to those threatened by internal competition, particularly if we retain the fundamental system of economic competition. And we might ask why such assistance should be available when our total national effort to upgrade our resources, especially our human resources, is not nearly sufficient to meet those powerful social and economic strains that now menace our society. We can argue also that the basic fiscal and monetary policies that provide full employment, encourage investment, promote efficiency, and accelerate growth probably could do more to offset import competition than a host of protective quotas or other restrictions.

If we decide to preserve a national commitment to freer trade, we will need policies strong enough to withstand the pressures for ever-increasing import controls, policies that provide for careful investigation and evaluation of protectionist claims, programs that provide economic assistance for adjustment in cases where import activity actually does injure resources that are not fully mobile, and policies that keep the total economy active and growing. Those who seek protection from import competition should recognize that the growth of international trade is in our national interest. It contributes to faster economic growth and lower prices both at home and abroad, and it results in higher living standards for everyone. Individual claims for special restrictions must be balanced against the problems they will cause in other sectors of the economy and in our international economic and political affairs.



## Brief Glossary of Trade Terms\*

**Concession:** Agreement by a country or customs union to reduce or bind (not increase) a tariff rate. Concessions usually are made on a reciprocal basis.

**Dumping:** As defined in Article VI, General Agreement on Tariffs and Trade (GATT), a means “by which products of one country are introduced into the commerce of another country at less than the normal value of the products.” GATT condemns the practice if it threatens or causes material injury to an industry within the importing country or to an industry in a third country that regularly sells to the importing country. GATT recognizes the right of an importing country to protect itself against injury by imposing antidumping duties that are no greater than the amount by which an exporting country’s domestic price exceeds its export price.

**Exchange Restrictions:** Direct governmental control of the demand for and supply of foreign exchange. In controlling foreign exchange, governments sometimes issue exchange licenses to importers who buy foreign currency for particular purposes only, thus enabling the country to control the imports of certain goods from exporting countries. Similarly, a country short of foreign exchange may utilize multiple exchange rates to limit imports of certain types of goods. With such a system, the country sets varying rates of exchange between its own currency and foreign currencies, depending on import classes. For needed imports of industrial goods, a rate may be set that makes the price of such goods in the foreign currency cheap in the currency of the importing country. Or the rate for luxuries may be set to raise the price of such imports in terms of the importing country’s currency.

**Export Subsidy:** A government grant made to a private enterprise for the purpose of facilitating or expanding exports. GATT requires member countries to report on all the subsidies they grant. If the interests of any other country are prejudiced, the country granting the subsidy may be required to

discuss the possibility of limiting the subsidization. The rule states that countries should avoid subsidies on the export of primary products. When they do subsidize such exports, the effect should not be to give them more than an equitable share of world trade in the subsidized product.

**Mixing Regulations:** Regulations requiring that raw and/or processed products sold domestically contain a designated portion of domestically produced materials. For example, as of January 1, 1966, Australia requires that 50 percent Australian leaf be used in all tobacco products manufactured in that country. Also, some countries require flour millers to use a certain percentage of domestic wheat in the grist. In effect, mixing regulations limit the quantity of foreign commodities that can be used in domestically manufactured products.

**Quotas:** Limitations on the quantity or value of a product that may be permitted to enter a country during a specified time period. Quotas are classified as nontariff trade barriers. Most countries use quotas of one kind or another to control some agricultural imports.

**Retaliation:** Action taken by a country because of the withdrawal, suspension, nullification, or impairment of a trade agreement concession by one of the parties. The withdrawal or suspension could take the form of increased duty rates, establishment of import quotas, or other action aimed at maintaining reciprocity.

**Tariff:** Usually refers to a list or schedule of articles with the duty rate to be paid to the government for their importation. The U.S. tariff schedule lists hundreds of foreign-produced items on which the United States levies duties—automobiles, wine, cameras, farm products, and many others—and specifies the duty to be assessed against each item. The word sometimes is used in the sense of a duty levied according to the tariff schedule, such as “the tariff on wine.” It also may be used to mean the law that fixed and imposed a schedule of duties. Tariffs may be protective—designed to protect domestic production against the economic effects of imported goods—as contrasted with revenue—established to bring revenue to the government.

**Variable Import Levy:** Used by the European Economic Community (EEC), broadly speaking, to make up all or part of the difference between the EEC’s threshold or gate price and the price of products offered by non-EEC countries at its frontiers. It is used for grain, rice, pork, poultry, eggs, and olive oil. The variable levy sometimes is called an equalization fee or equalization tax. It is less frequently referred to as a skinning charge or, simply, skimmings. For example, it is said that the EEC, through its variable system, skims off the difference between world wheat prices and the relatively higher prices in the EEC.

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\*These definitions are drawn largely from *Terms Used in International Agricultural Trade*, FAS-M-152 (Revised), Foreign Agricultural Service, USDA, April 1967.