I MACROECONOMICS AND AGRICULTURE IN LAC

(a) Brief macroeconomic background 1/

World macroeconomic and agricultural cycles have had a major impact on the economies of LAC countries and on the behavior of the agricultural sector in the region. During the 60's and 70's, LAC countries benefitted from the overall buoyancy of the world economy. There were indeed discussions regarding the adequacy and sustainability of the development strategy based on import substitution industrialization (ISI) (which was criticized because its negative impact on growth, macroeconomic stability, technological innovation and income distribution), and clearly accelerating inflationary pressures also led to worries about the adequate management of fiscal and monetary policies in the region. The oil shocks during the 70's were weathered in part because LAC's exports were helped by the increase in the prices of commodities (agricultural and non-agricultural), and because of the increased availability of financing in private world capital markets.

The radical change in world macroeconomic conditions after the second oil shock, found LAC countries very vulnerable, in good measure because of policies that had left the region with a comparatively small export base, very dependent on primary commodities, and a greatly expanded external debt. The policy debate regarding the proper development strategy during the 70's was submerged by the urgency to absorb the triple shock in declining terms of trade and export volumes and skyrocketing interest rates, which hit the region at the beginning of the 90's. Although the rigidities of the inward-oriented development strategy hampered the possibility of an easy adaptation to the new circumstances, the size of the shocks was such that a painful process of adjustment was unavoidable. Different calculations showed that the increase in interest payments and the decline in the terms of trade amounted to a negative shock of almost 4% of the LAC’s GDP in 1982. And after the Mexican crisis in August 1982, external financing, that during 1980-1982 had been about 5% of the GDP, dropped to 1% in 1983 and became nil during 1984 and 1985 (see references in Diaz Bonilla E. 1991a).

The region suffered another trade shock in 1986, when commodity prices collapsed worldwide. Although interest rates declined in nominal terms, they stood high in real terms, particularly if deflated by the prices of the region’s exports. This new shock hit hard LAC countries, in many

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1 This is based mainly in Diaz Bonilla 1991a, and Reca and Diaz-Bonilla, 1997.
cases erasing the gains of the adjustment efforts of the first half of the decade.

The process of adjusting domestic absorption and the current account to the reduced international funding and value of exports, fell comparatively more on investments and imports, which affected the rate of growth of the economies. At the same time, money financing of the reduced but still high fiscal deficits led to higher and more variable rates of inflation in the region. Inflation moved from an annual average of approximately 45% (consumer prices) during the 70's to almost 190% per year during the 80's. The unstable macroeconomic framework affected both private investment and the banking sectors, further depressing economic activity. While from WWII to the end of the 70's the region grew at an average of 5-6% per annum, the growth rate declined dramatically to an annual average of 1% during the 80's (and it was negative between 1981 and 1984). These growth rates were below population growth, and therefore income per capita declined during the 1980's.

By the end of the decade, the strong adjustment effort, helped since 1989 by the implementation of the Brady Plan, led to better external indicators for several LAC countries, but internal economic and social indicators still reflected the difficulties of the decade. Prices of LAC’s export commodities continued to be soft. At the policy level, governments in the region continued with the process of fiscal consolidation, at the same time that domestic markets and international trade were progressively liberalized.

Following the deceleration of the world growth at the beginning of the 90's, macroeconomic conditions changed once again, when the Federal Reserve shifted to an expansionary monetary policy to try to get the US economy out of the 1990-1991 recession. This coupled with an improved policy environment in LAC led to an important surge in capital flows to the region from 1991 until the end of 1994. After a brief interval following the 1994 Mexican devaluation, capital continued to flow to the region, lifting the external constraints under which the region had been operating during the 80's and leading to the resumption of growth in the region to about 3.1% per year.

However, the recent financial crises in Asia, Russia and Brazil, have changed again the macroeconomic environment, and are negatively affecting the growth rate of the region in 1998 and 1999.

(b) The agricultural sector

The dynamics of the agricultural sector of LAC reflects both long-term trends as well as the impact of changes in domestic and international macroeconomic and sectoral conditions. Overall, the share of agriculture in total GDP in LAC has followed a well-known pattern: as income grows, the relative importance of agriculture has declined. In the period 1970-1995 agriculture in LAC grew at an annual rate of 2.7%, while regional GDP expanded at 3.3% per year. As a result, while agriculture contributed with 16% of total GDP in the region in the mid 60’s, currently, the share of agriculture is about 10%. Yet, there is a broad range within the region: from 4% in Venezuela to around 10% in MERCOSUR and 16% in Central America.

There has also been a strong trend toward the concentration of economic activity in the large
economies of the Region. The combined total output of Brazil, Mexico and Argentina grew from 62% of the regional GDP in the mid 60's to 80% in the mid 90's. At the same time there has been a concentration in agricultural value-added: while the three largest economies accounted for 58% of the value added in that sector in 1965, the corresponding figure for 1995 was 77%. Brazil, the largest economy in LAC contributed with one fifth of the regional agricultural GDP in the mid 60's, while the Brazilian share thirty years later was one third of the LAC's agricultural GDP.

The pattern of agricultural growth, however, has not been uniform during the last 25 years. After an initial drop, during the 70's there was a distinct acceleration in agricultural production in LAC (Chart 1): high world prices fueled the expansion of exportable and import- substitution agricultural products, while strong domestic demand sustained those products that (because trade restrictions or intrinsic characteristics) were non-traded goods and the expansion of the industry provided demand for agricultural raw materials. It is true that the economy grew faster than the agricultural sector during this period, but the sectoral growth was significant nonetheless, and stood above the GDP growth rates achieved in subsequent years.

It has been demonstrated that during this time the agricultural sector and rural areas were affected by a policy strategy biased toward the industrial sector and urban areas (see, for instance, Krueger et al, 1991). However, supportive world markets and domestic income growth, appear to have been enough to generate comparatively higher growth rates in the agricultural sector of LAC (Diaz Bonilla E. 1990).

During the 90's, as indicated, world and domestic conditions for the agricultural sector of LAC changed substantially. Devaluations of the exchange rates and the progressive advance of trade liberalization removed at least part of the policy bias indicated. Real exchange rates (defined as the price of tradable over non tradeable) increased in many countries in the region, favoring export and import substitution agricultural productions. However, reductions in government expenditures in infrastructure and technology, as well as the elimination of marketing and price support programs that were benefitting specific crop and livestock production in several countries, tended to affect supply negatively. Also the higher cost of imported inputs (as a result of the devaluations), and the reduction of credit to agriculture by the public and private banking sectors (partially linked to macroeconomic stabilization programs), had a negative impact on agricultural production. The slow down in domestic demand affected livestock and dairy productions, which have an important component of domestic consumption, the crisis of the industrial sector carried over to some agricultural raw materials, and the weakness in world markets hit hard exportable agricultural goods and made difficult for LAC governments to continue the support of some import-substitution products, such as wheat (Diaz Bonilla, 1990).

As a result of this combination of positive and negative circumstances, agriculture held better than the rest of the economy during the harsh decade of the 80's and continued to grow, even above the average for the economy and far more than the industrial sector. In consequence, over time, agriculture has shown a much steadier path than either the manufacture sector or the whole economy. The variability of the agricultural growth rate has been about one third than that of the whole economy.
The positive impact of the remotion of the policy bias against agriculture (through devaluation of the exchange rate and trade liberalization) was in good measure offset by several factors such as the decline in world prices (in the case of tradeable goods); the slowing down of domestic demand (which affected livestock and dairy production); problems of the industrial sector (which reduced demand for agricultural raw materials); lack of infrastructure and credit, higher prices of inputs and machinery, and, in the case of the non trivial segment of crops that received net support from LAC governments (in spite of the overall policy bias against agriculture), the termination of such programs under the pressure of fiscal constraints and lower world prices (Diaz Bonilla E. 1990).

In the 90's, however, after a slow start due to the continuation of low growth at the world level and in the region, LAC's agricultural production picked up again, at least until 1998. The full impact of the financial crises that begun in 1997 in Asia is still to be seen.

II. TRADE PERFORMANCE

During the 90's, a general process of trade liberalization took place in the region, as a result of different causes. One of them, has been the advance of regional trade integration, which included the creation of new trade agreements (such as NAFTA and MERCOSUR), the revitalization of older ones (such as the Central America Common Market, the Andean Pact and the CARICOM) and the proliferation of smaller trade pacts (such as G-3, and the active presence of Chile in the signing of bilateral agreements). Moreover, several countries in Latin America liberalized their trade regimes in the last decade either because they joined the GATT (Mexico in 1986 and Venezuela in 1990), or because they unilaterally pursued policies of greater openness (like Chile and, more recently, Colombia, although in the latter case there has been some reversal of policies).

This has changed the policy environment.

In some products, the combination of trade liberalization, some appreciation of the exchange rate (linked to larger capital flows), low world prices and the termination of internal support due to fiscal constraints have led to larger imports. But the restructuring of the agricultural sector is also generating larger exports.

Historically, LAC has had a positive net agricultural trade balance, which in 1996 amounted to about 20.2 billion dollars in current terms (see Chart 2). However, the ratio between the value of agricultural exports and imports has fallen significantly from about 3-3.5 in the 60's to around 1.70 in the 90's.

The overall positive trade balance masks wide differences in the region. Looking at the agricultural export/import ratio in individual countries, important differences exist: from Argentina and Costa Rica, which have ratios of more than 8.5 and 5.5, respectively, to Haiti, Peru, Bahamas and Venezuela, with ratios of 0.3 or less.

In terms of individual products, one of the most important developments of LAC agriculture in the recent past has been the emergence of fruits and vegetables as the leading agricultural export of the region (in value terms), displacing traditional commodities. Along with the growth of the
oilseeds complex, both groups account for an important part of the increase in production and the continuation of a surplus in net agricultural trade. On the other hand, traditional exports such as coffee and sugar have decreased in importance.

The region has been usually a net importer of cereals and dairy products, and the gap appears to have increased lately. This seems related more to increases in consumption than declines in production, which, for the region as a whole, has accelerated in recent times compared to the 1980's (although there have been declines in production in some countries). The resumption of economic growth, lower world prices, the opening up of the economies and the surge in capital inflows leading to some appreciation in exchange rates in the region have been pushing imports up since the late eighties.

An important characteristic of agricultural trade (and, in fact, of all international trade) in the region, is the steady increase in the share of intraregional commerce, which, for the Americas (including USA and Canada), moved from 1/4 of total agricultural exports in 1981-1983, to more than 1/3 by mid-1990's. Among LAC countries Brazil is the less dependent on the region for its agricultural exports and imports, while Mexico appears on the other extreme of the spectrum. Other countries with greater diversification in the destination of exports and the source of imports of agricultural products and food are Argentina, Chile, Peru and, to a lesser extent Uruguay and Colombia.

Regional pacts have had an impact on the trade flows of their respective members. Clear cases are Mexico with regard to NAFTA and Uruguay, Paraguay and (to a lesser extent) Argentina with respect to MERCOSUR. But, for obvious reasons, NAFTA also has a strong presence in the trade flows of nonmembers countries in the region, including Brazil (for whom in terms of agricultural and food exports, NAFTA is more important than MERCOSUR).

All in all, the process of trade liberalization that has taken place in the region and the implementation of trade agreements have fostered agricultural trade. This has led to larger coefficients of internationalization, measured as exports over production and imports over consumption, for a variety of agricultural products, indicating a larger exposure of LAC's agricultural sector to world markets (Chart 3 shows aggregate values).

The evolution of trade flows will depend, inter alia, on trade and agricultural policies in the Americas and elsewhere, which, in turn will be influenced by different multilateral, regional and bilateral agreements that will result from the complex negotiations ahead. These negotiations include the continuation of the process initiated during the Uruguay Round of GATT, and, for the countries of the region, the possibility of creating a Free Trade Area of the Americas, as well as extraregional negotiations such as the participation of NAFTA countries and Chile within APEC, and the discussions between MERCOSUR and the European Union. The next section presents a brief review of possible trade agricultural issues in those negotiations.
III. TRADE POLICY ISSUES IN THE REGION

1. Exports subsidies, dumping and related issues.

For the agricultural sector of LAC countries in general, one key issue would be the elimination of export subsidies. As part of the negotiations of a Free Trade Area of the Americas, the idea of declaring the American Continent as a subsidy-free region has been discussed. In the coming WTO negotiations LAC countries will certainly push for the elimination worldwide of exports subsidies in agricultural goods. The subject of state trading enterprises (with the possibility of increasing disciplines and transparency on practices that may operate as subsidies or dumping on the export side, or hidden trade barriers, on the import side) will also be of interest to LAC countries, along with the proper administration of current remedies, such as countervailing duties and antidumping measures (although this last issue is a broader subject that goes beyond agriculture). Finally, different LAC countries have been urging the integration within a unified framework of the three groups of disciplines related to export subsidies, export credits and food aid, to avoid loopholes and "grey-areas".

2. Market Access

The patterns of trade and market access in different countries in the continent will be influenced by the complex system of border measures resulting from the implementation of the Uruguay Round, NAFTA, and MERCOSUR and the revitalization of Central American Common Market the Andean Pact and CARICOM, as well as by the potential agreements between countries in the region and extra regional partners (the UE and APEC for example). The analysis of different scenarios will require the utilization of general equilibrium models of international trade, to disentangle the possible effects. IFPRI, along with other institutions is very active in the implementation of empirical models for trade policy analysis.

Opportunities for expanded market access will depend on increasing the volume of imports allowed under the current regime of tariff-rate quotas; on further reduction of tariffs, particularly those still very high in some key products, such as fruits and vegetables, sugar, meat and dairy products, among others; and on completing the process of tariffication in the cases where exemptions were granted. Also, the elimination, or at least the reduction, of tariff escalation is an important subject for less developed countries, to the extent that this practice undermines their possibilities of generating local employment and increasing the value added of their products.

The traditional subject of the administration of safeguards will also be part of the discussion, along with issues such as price bands, rules of origin, technical standards, customs procedures and classification of goods, measures taken at the sub-national (provincial) level, and, in general, administrative procedures of the different agencies that may have a participation in the regulatory or operational aspects of import/export activities.

3. Domestic support
The final agreement on domestic support reached at the Uruguay Round did not impose the disciplines initially envisaged in the Dunkel Proposal of the Draft Final Act, particularly because the measure of support was transformed from a product-based one to an aggregate value for the whole agricultural sector, and the main domestic subsidies of the US and the European Union were kept outside the disciplines in what was called the "blue box".

LAC countries, which for reasons mainly related to fiscal constraints, have dismantled or significantly reduced their own domestic support for agricultural producers, will probably push for further disciplines in this regard, particularly the tightening of the criteria for the green box, the definition of the measure of support by product and the elimination of the exemptions considered under the blue box. With the changes in the 1996 Farm Bill in the US, currently only the European Union's domestic subsidies are in the blue box. However, if low world prices persist, and with a far stronger fiscal position in the US, pressures to revert to the old system will mount in this country. Therefore, LAC countries, specially net exporters, will try to maintain on the table the issue of further disciplines on trade-distorting domestic subsidies.

4. Sanitary and Phytosanitary Issues

The regulatory frameworks for development, adoption and implementation of measures to protect human, animal and vegetal health from risks caused by animal or vegetal diseases, foods, additives or contaminants, constitute an important area within the agricultural negotiations of the Uruguay Round.

The regional experience in the context of expanded agricultural and food trade shows the increasing importance of sanitary and phytosanitary (SPS) issues in trade disputes. Here, a key issue will be to discern between legitimate differences in the interpretation of scientific evidence from the protectionist uses of SPS measures. Rather than reopening the SPS agreement, many LAC countries will probably prefer to allow the process of dispute settlement to clarify the issues involved.

5. Other Trade-related Issues

For LAC and the Americas, in general, an important issue is the interaction between the different levels of trade negotiations: the WTO process beginning in 1999, with the trade talks regarding a Free Trade Area of the Americas (where an Agricultural Committee has been recently created) and the continuation of the subregional agreements in the American continent.

Although LAC is a net agricultural exporter and several of the larger producing countries are part of the Cairns Group (Argentina, Brazil, Colombia, Chile, Paraguay and Uruguay), there are several net agricultural importers in the region (Mexico, Peru, Venezuela, Haiti, Dominican Republic, Surinam, Trinidad-Tobago and Barbados). These countries will be concerned about export taxes, export prohibitions and other measures that may hamper their access to food supply.
at adequate prices, and which may increase volatility in world markets. Also they will carefully consider the impact of trade negotiations on their food bill, in terms of the total cost and volatility.

Genetically modified agricultural products present a special challenge on several dimensions, including the implications for the WTO intellectual property rights framework, and the proper administration of the agreement on technical barriers to trade (for example, the issue of labelling in some importing countries).

Finally the debates over the links between trade, labor and environment, will require an important analytical effort in the LAC region, to try to separate legitimate concerns from the utilization of those issues for protectionist purposes.

6. Social concerns

The impact of the trade and agricultural policy changes on poor consumers, on the demand side, and small producers and minifundistas, on the production side is a matter of debate in LAC. Concerns have been voiced about trade liberalization leading to greater food price instability that may hurt the poor, and displacement of small domestic producers by cheap food imports.

On the other hand, greater productivity and growth coming from better trade and sectoral policies should help the employment conditions and income generation process in LAC countries, benefitting the poor, given an adequate operation of markets and social institutions. The growth of exports of the fruit and vegetable complex, with its labor-intensive structure, is an example of LAC countries following their comparative advantages, which requires to keep adequate access to the developed countries' markets. Additionally, the Uruguay Round has begun to discipline the unfair competition of subsidized and dumped exports, while at the same time allowing developing countries to maintain stocks for food security purposes, the provision of domestic food aid for population in need, and the implementation of decoupled systems of farm support (such as Procampo in Mexico).

The issue here is the adequate design of domestic policies to achieve the intended objectives of price stability and poverty alleviation, which most certainly will not be helped by trade distorting interventions.

LAC countries as a whole, exporters and importers, should also be interested in the adequate funding of food aid (including special funds for emergencies), within an integrated framework of disciplines that considers the continuum from food aid to commercial credits.

7. The Political Economy of the Negotiations

A key question relates to the political economy of the negotiations: the incentives and disincentives for the different countries to participate in the negotiations. LAC is a vast region, with exporters of agricultural products from temperate climates, exporters of subtropical and tropical goods, and net food importers. Some of them may worry about domestic and export subsidies in cereals, oilseeds and meat; others may be concerned about quotas, tariffs and the
application of SPS measures in fruits and vegetables; others yet may be troubled by high barriers in tropical products like sugar and tariff escalation in many products, that may enter at low tariffs only if not processed; and, as indicated, countries with trade deficits in agricultural products will be concerned that trade negotiations do not increase their import bill.

At the world level, the alignment of issues is also very different from the Uruguay Round. Then agriculture was part of a larger negotiation, giving more leverage to those countries interested in an agricultural deal which could block the rest of the package; US and Europe were under pressure to reduce the fiscal cost of agricultural support; world agricultural markets were badly distorted and the subsidy war between these two major exporters was very expensive and was depressing world agricultural prices.

Now the fiscal position has improved significantly in USA and the European Union has also reduced fiscal deficits; the Uruguay Round helped to reduce some of the distortions of the world agricultural markets, and past subsidy wars seem to have decreased in intensity. Also, except that the multisectoral Millennium Round takes off, the continuation of the negotiations in agriculture may be conducted separate from other issues. This would reduce the leverage of countries interested in further reforms. Even for the developed countries with a highly protected agriculture which may want to reduce such protection, a stand-alone negotiation makes it more difficult to balance the interests of different domestic groups.

The political economy of the trade negotiations, as well as the quantitative estimation of different scenarios for those negotiations, are important issues that will have to be considered by LAC countries to develop their own negotiating positions.

8. Macroeconomic issues, capital markets, and economic instability.

The importance of macroeconomic policies for the agricultural sector is widely recognized. Particular emphasis has been placed on the impact of the exchange rate policy on agriculture, but, in fact, is the whole macroeconomic program which is relevant, including monetary and fiscal policies (Díaz-Bonilla and Robinson, 1997).

Moreover, in a world with increasingly larger financial markets, the dynamics of trade flows, contrary to past history, appears to be dominated by capital flows. Therefore, coordination of macroeconomic policies may be more important for commercial flows, including agricultural products, than trade negotiations.

The developments in capital markets may also affect price stability, including for agricultural products. While expanded trade should reduce world price volatility (to the extent that supply and demand conditions are averaged over a larger set of countries, and economic and weather circumstances), if capital flows have become more volatile, then world prices will also show greater variability. But this would not result from expanded trade in agricultural products, which in fact may have contributed to reduce volatility. Regarding price stability, the challenge, at the level of the agricultural sector, may well be the need to devise market-based schemes of income stabilization, utilizing the far larger pool of financial resources and instruments in capital markets.
LAC Total Agricultural Production
(FAO; Indices 1989-1991=100)

LAC: Net Trade (Billion US$)
Current and Constant 1989-91 Ag. Prices

- Constant Prices
- Current Prices
Total Agricultural Production
Exports and Imports as % Total Prod.