World events shaping future U.S. agricultural trade

by Jerry Sharples, in collaboration with Lon Cesal, Hunter Colby, Christian Foster, David Kelch, Robert Koopman, Daniel Plunkett, and David Sedik

After the boom years of the 1970s, the 1980s were less kind to U.S. agriculture. In the 1970s U.S. agricultural export sales fed the boom, increasing at an annual rate of over 20 percent. But in the 1980s, exports actually declined, and have not recovered to their 1980 level. What about the future? Will agricultural exports over the next fifteen years grow as they did in the 1970s, stagnate or decline as happened in the 1980s, or be somewhere in between?

Currently unfolding world events are causing more than the usual amount of trade projection uncertainty. Economic analysis of those events is part of our job in the Agriculture and Trade Analysis Division (ATAD) of the Economic Research Service, USDA. I asked our ATAD experts, "What non-U.S. 'events' do you think will have the most impact on U.S. agricultural trade over the next fifteen years?" The list of responses included global events such as population growth, new cost-reducing production and transportation technology, environmental problems, and GATT. But the list was topped by political events in China, Europe, the former Soviet Union, and Latin America. This story is about how the unfolding political scene in these four regions could shape future agricultural trade, as told by ERS's experts on those regions. Their opinions do not necessarily represent official USDA positions.

China: Will Asia's largest dragon roar onto world agricultural markets?

China is the world's largest agricultural producer and consumer, but in the last thirty years it has been a relatively minor and sporadic world trader of agricultural products. There is, however, the potential for substantial growth of trade. China's economy is experiencing record economic growth. Economic reforms appear to be working. China's population continues to grow and per capita income is rapidly rising. Economists predict China will demand substantially more food of greater variety and higher quality. Future food production

Figure 1. World and U.S. AgricultureTrade

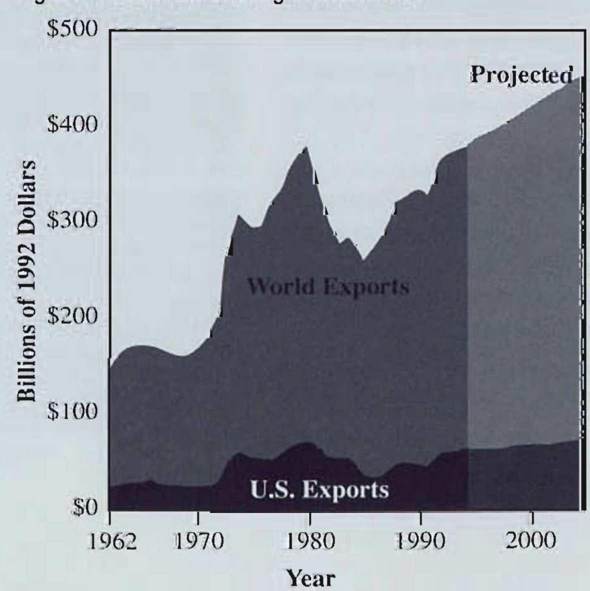
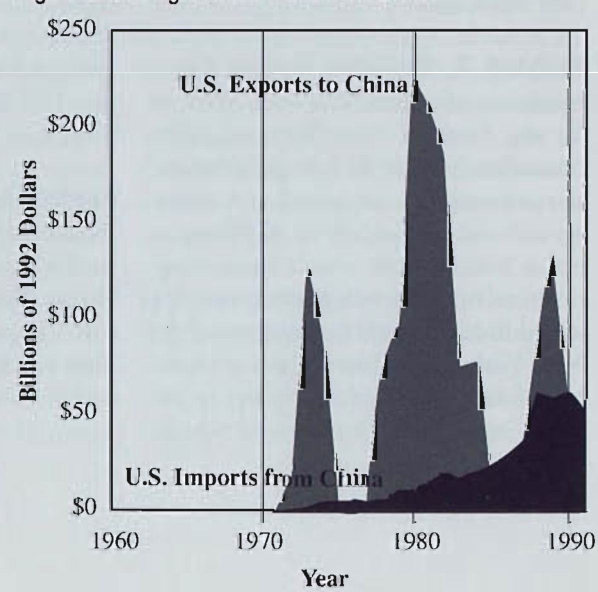
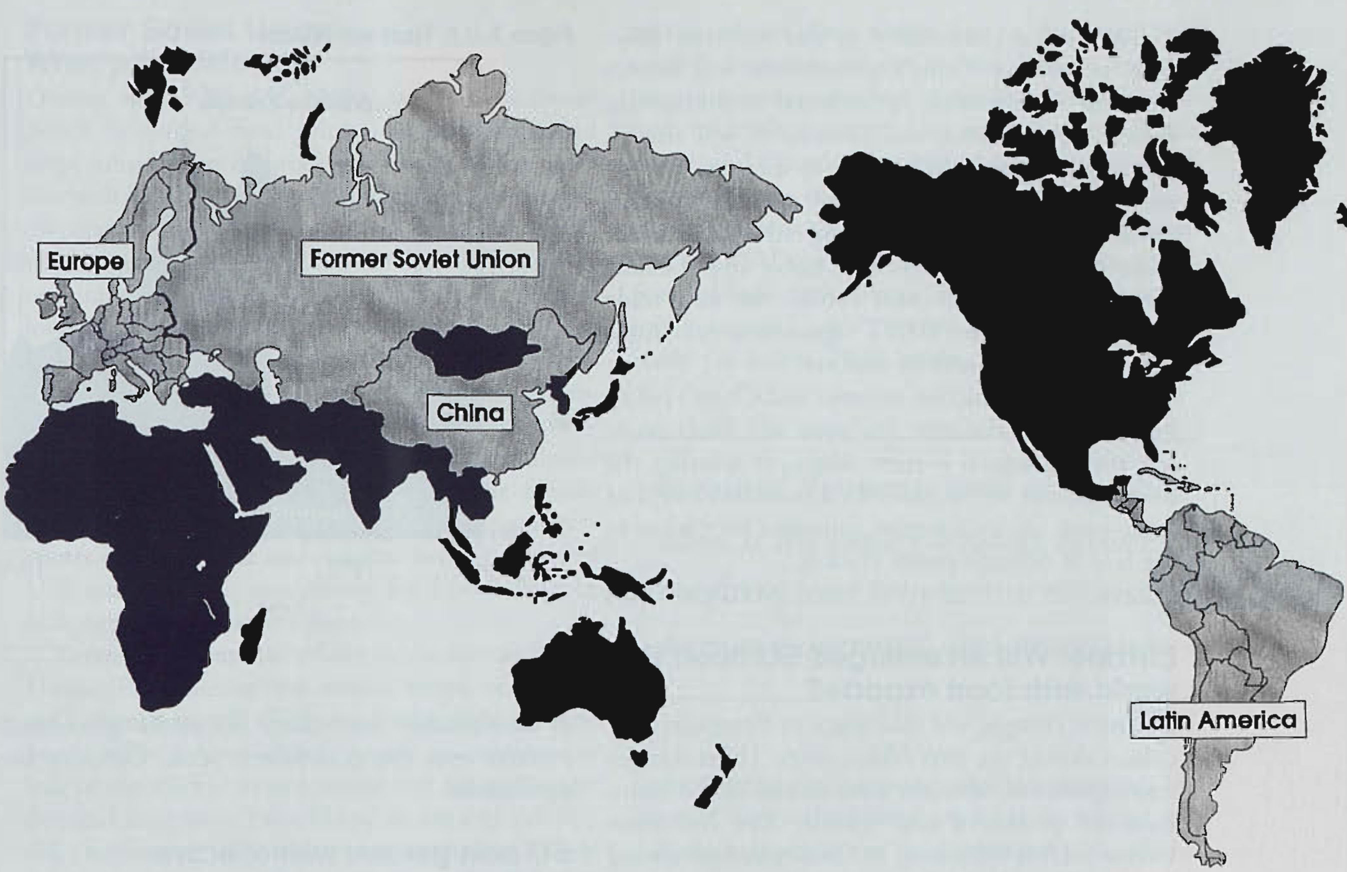


Figure 2. U.S. Agriculture Trade with China





and government policy in China, however, are quite uncertain. How rapidly can China's farm production expand? How quickly can the food handling, transportation, and processing infrastructure be upgraded to deliver farm goods to urban centers? Will China open trade or discourage trade? Here we consider two very different scenarios for China's future agricultural trade that illustrate the significance of the uncertainties: a "self-sufficiency" scenario, and an "evolving trade" scenario.

Self-Sufficiency

In the "self-sufficiency" scenario, production of grains and meats expand about in step with domestic demand (with the likely exception of wheat and oilseeds), and policy discourages trade—especially imports of "nonessential" or "luxury" foods. This scenario assumes that production incentives would increase, whether from government support prices, government edicts, or market forces, to largely supply China's expanding needs. Since the economic reforms began in 1979, farmers impressively increased the output of most major crops and livestock. Recent evidence from China indicates that crop yields were over-reported in the past. China may still have substantial room for additional growth in yields to raise production of basic food needs as population increases. If domestic production roughly meets basic food needs, policy makers may pursue self-sufficiency objectives and discourage agricultural imports, even in the face of rapidly increasing and changing consumer demand. In this scenario, government intervention in the production and distribution of agricultural commodities would result in China being essentially trade-neutral in most commodities, except for imports of wheat and, perhaps, oilseeds.

Evolving trade

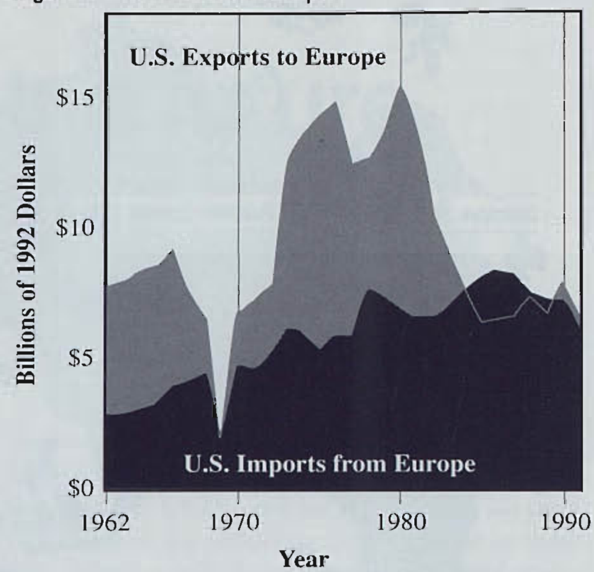
In the "evolving trade" scenario, China achieves somewhat less rapid and less distorted growth in agricultural production, government trade policies are more open, and agricultural trade expands. Consumers—especially those in the large coastal cities—have money and want to purchase more and a greater variety of high-quality food products. In this scenario, government policy allows increased agricultural trade, along with policies that encourage production patterns more in line with world price signals. These policies foster shifts in China's cropping patterns toward more profitable fruits and vegetables and away from grains, particularly rice. Therefore, imports of some grains and feeds and high-valued food products increase substantially. In addition, China expands agricultural exports, including rice, fruits, vegetables, and poultry meats.

The central uncertainty in this scenario, however, is whether China's government will restrict imports to essential agricultural commodities (wheat, cotton, corn, and oilseeds) or will also allow other nonessential imports to increase. For example, would China import raw agricultural commodities for domestic processing rather than value-added products such as meat or edible oils? If China enters GATT in the near future, the new trade rules of the recent GATT agreement will limit China's ability to restrict imports.

Improved production statistics and China's policy initiatives over the next few years will likely point out which scenario is more likely, or whether the final outcome will actually be a muddled blend of both—not an uncommon outcome in China in the face of difficult policy choices.

—Hunter Colby

Figure 3. U.S. Trade with Europe



Europe: Will an enlarged EU flood the world with food exports?

Dramatic changes will take place in European agriculture during the next fifteen years. These changes may significantly alter the amount and kind of commodities produced and traded. The European Union (EU) is reforming its Common Agricultural Policy (CAP). It is also considering enlarging to include most of the countries of Eastern and Western Europe. A major concern for U.S. agricultural trading interests is the potential for increased competition in world markets from a highly subsidized, and increasingly productive European agricultural sector. On the other hand, continued effective reform of the CAP in an expanded EU disciplined by the recent agreement on agriculture in the GATT could significantly reduce the threat of subsidized exports.

During the past four decades, agricultural policy of Central and East European (CEE) countries held consumer prices artificially low and fixed producer prices, on average, at or slightly below world prices. As a result of these policies and inefficiencies, CEE countries typically imported grains and oilseeds from the West and exported small quantities of livestock products and fruits and vegetables to the Soviet Union.

The EC followed a much different approach. The CAP guaranteed very high producer prices that gave farmers extra incentive to produce but discouraged consumption. As a result, between 1975 and 1990 the EU became a major net exporter of grain instead of a major net importer. In 1992, in an attempt to curb its excess production and reach an agreement in the GATT negotiations, the EU agreed on a three-year reform of the CAP. The possibilities of EU enlargement, along with CAP reform and the agreement in the GATT, are sources of considerable uncertainty for world agricultural markets over the next fifteen years. Consider the possibilities.

EU enlargement with effective CAP reform

Continued reform of the CAP over the next fifteen years—disciplined by the GATT agreement that limits export subsidies, limits internal support to producers, and increases access to EU markets by exporters—could result in EU farm prices near world prices. The internal and external constraints posed by GATT commitments would likely decrease the EU's trade surplus in many commodities. EU enlargement accompanied by effective reform of the CAP would provide CEE producers with greater incentives to produce and export than they currently receive, but increased CEE exports would likely be offset by lower exports from other EU members. These reform measures would generally help expand U.S. agricultural exports.

EU enlargement with ineffective CAP reform

With ineffective CAP reform, the EC fails to significantly reduce production incentives and does not use effective supply controls. This scenario assumes that the GATT agreement also is ineffective in constraining production growth. If the "reformed" EU policies continued to produce large surpluses, and these policies extended to new CEE entrants, European agricultural exports would continue to expand at the expense of U.S. exports.

—Robert Koopman, David Kelch, and Daniel Plunkett

Former Soviet Union: What pace reform?

During the 1970s and 1980s, Soviet agricultural policy held retail food prices low, and channeled large subsidies to livestock producers. These policies built large livestock inventories, greatly increased the demand for grain, and transformed the USSR from a grain exporter in the 1960s to the number one importer of grain in the world. As a result of low retail prices, Soviet meat consumption in 1990 was approximately twice as high as non-socialist countries with similar per capita incomes. Moreover, inefficiency in the food industry led to extraordinarily high levels of waste for all agricultural commodities. Throughout the 1980s, the former Soviet Union was traditionally the number one purchaser of U.S. wheat and number two purchaser of U.S. coarse grains, accounting for $2-3 billion in U.S. agricultural exports per year.

Successful economic reform in the former Soviet Union (FSU) means that market forces, not political commands, will drive most economic activity. Some reforms have already begun to increase the role of the market in agriculture and reduce import demand for grains. Price liberalization and the partial elimination of livestock subsidies have already led to higher prices for livestock products, compared to other foods. Along with a reduction in real incomes, relative price increases have led to reduced consumer demand for meat. As lower demand is passed through to the supply side, the FSU livestock sector has and will continue to downsize, thus reducing import demand for grains. Other reforms have barely begun, but if carried out, should further reduce grain demand. These include privatization of agricultural production, trade and processing, the parallel phasing out of the state procurement system and the reduction of automatic credits to agricultural producers. If implemented, these reforms should restore incentives for careful husbanding of resources and reduce waste, further reducing import demand for bulk agricultural commodities.

These new market forces will likely continue to lower import demand for grains. However, the pace of restructuring and marketization will affect U.S. agricultural trade over the next fifteen years.

Reform at a fast pace?

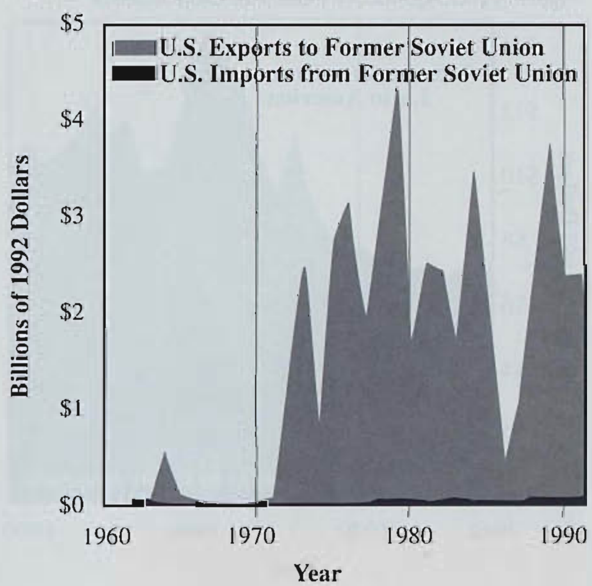
The pace of agricultural reform in Russia depends on the ability of reformers in the Yeltsin government to further the above-mentioned reforms. The dissolution of the old Supreme Soviet and the passage of the new Russian constitution has probably given the Yeltsin government more leeway to pass legislation aimed at furthering agricultural reform, increasing the chances that market institutions could be securely in place within five to ten years. Successful economic reform should lead to reduced per capita consumption of grains and livestock products to levels more in line with the rest of the world, and a production mix of crops and livestock products more in line with market price signals. If successful reforms are fully implemented throughout the FSU over the next five to ten years, imports of bulk agricultural products could be cut in half compared with current levels, which are already far below 1990 levels. But in addition, as economic activity picks up and incomes rise, imports of high-valued food products, as well as specialized equipment for food processors, should increase.

A central theme in each of the these cases is the policy tension between reform and retrenchment, and between openness and protection.

Reform at a slow pace?

The pace of institutional reform could still be slowed by internal political resistance, given the strong showing of the anti-reformists in the federal assembly. A more pessimistic rate of reform would stretch the market-oriented institutional changes to ten to fifteen years, delaying the trade effects as well. Slow reform would reduce the pace of adjustments in

Figure 4. U.S. Agriculture Trade with Former Soviet Union



per capita food consumption, production and marketing waste, and crop mix. This scenario, relative to the first, implies more grain imports over the next fifteen years, but still well below historical levels. Grain imports would require subsidies through foreign aid. But, due to lack of income growth, high-valued and niche import opportunities would be delayed.

—David Sedik and Christian Foster

Latin America: Market reforms? Yes. But...

Latin American countries are important agricultural trading partners with the United States. Extensive policy reforms are underway in these countries that could greatly modify historic trade patterns in the Western Hemisphere. Expanding free trade within the hemisphere is a key element of U.S. policy. Stimulated by NAFTA, many Latin American countries are altering their policies in preparation for negotiating "free" trade agreements (FTAs) with the United States and other Western countries. These countries have recently changed macro-economic policies, exchange rate policies, input subsidies and regulation, domestic agricultural programs, and trade policies. The reforms rely less on government intervention and more on open markets.

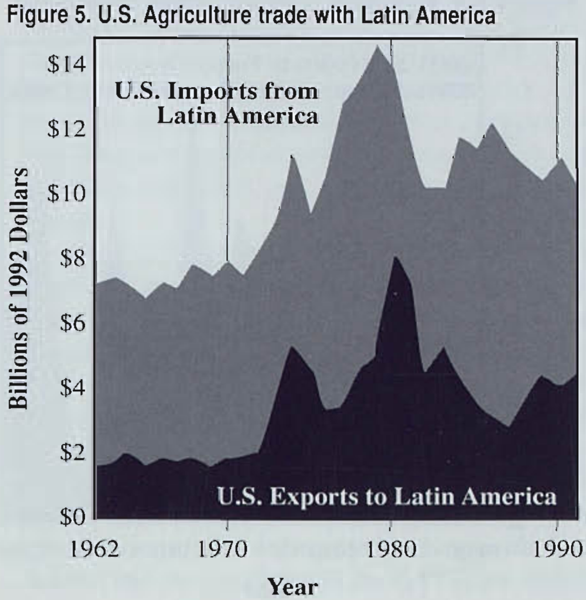
We expect that open markets with accurate price signals will promote more rapid economic growth and trade in Latin America. But resistance to policy reforms by those who benefitted from government intervention make the future of reform uncertain. Latin America's history has many examples of short-lived reform efforts. These alternative paths—market reform or renewed government intervention—lead to quite different futures for the region's agriculture.

Sustained reform

The combined effects of market-directed economies in the Western Hemisphere could substantially increase trade of agricultural products between the United States and Latin America over the next fifteen years. Reforms are expected to accelerate income growth and, combined with population growth, exploit agricultural comparative advantage. The agricultural sectors of Argentina and Brazil would continue to be highly competitive with the U.S., especially in oilseeds, meats, and sugar. Other Latin American countries, however, are unlikely to become major exporters of agricultural products because of their limited land and water resources. Rather, they would tend to consolidate their production around a limited number of products for which they have a strong comparative advantage, and import other products. Which countries develop comparative advantages for which products is very difficult to predict. The long history with extensive government intervention in agricultural markets in these countries means that it will take a number of years before free market prices sort out genuine comparative advantages. However, it seems very likely that with this scenario, two-way agricultural trade among the countries in the Western Hemisphere could grow significantly.

Recent history in Chile and Mexico illustrates the effect of policy reforms. Since consolidating its reforms in the early 1980s, Chile's imports of oilseeds grew at an annual rate of 21 percent and its exports of fruits at an annual rate of 20 percent.

Figure 5. U.S. Agriculture trade with Latin America



Similarly, since initiating its reforms in the early 1980s, Mexico's imports of meat and meat products grew at an annual rate of 35 percent and its exports of fruits and vegetables grew at an annual rate of 13 percent.

Faltering reform

The policy reforms in progress cause some hardship. For example, with NAFTA, small Mexican corn producers will be forced out of business because they cannot compete with large, efficient U.S. corn producers. All countries face adjustment costs. The public perception could be that these costs are too high. Political pressure could force leaders to slow or stop the reform process. With this scenario, as in the past, we expect relatively low levels of agricultural trade growth.

—Lon Cesal

So what?

So what do these four "most important" events imply for the future of trade for U.S. agriculture?

A central theme in each of the these cases is the policy tension between reform and retrenchment, and between openness and protection. One can visualize either of two polar global scenarios evolving.

Open to trade

We may see an evolving global trading system more open to trade. The discipline of GATT could help lock in market-driven reforms. Comparative advantage would play a more important role in the location of production. This is a scenario of rapidly expanding, highly competitive world trade in agricultural products. It also implies a trading system better able to absorb shocks. U.S. exporters of agricultural products who are innovative, who seek out opportunities, and are able to minimize costs of production, transportation, and handling, will prosper. With this scenario, substantial growth of U.S. exports of processed and high-valued products is likely. Foreign consumers with more income and more access to foreign goods will demand these products. On the other hand, bulk commodity exports will likely be a declining share of total world and U.S. agricultural trade, as it has been since the mid 1980s.

Protection

But a much different scenario may occur. Reforms by these countries and others may be slowed or even reversed because of public reaction to unemployment and other adjustment problems they may link to the reforms. Trade barriers—especially non-tariff barriers—could rise again to protect employment in "infant" or "strategic" industries. Self-sufficiency and protection, not integration, could dominate policy choices. These setbacks to reform could be temporary, but they would have a big impact on agricultural trade during the next fifteen years. This scenario offers less potential for growth of U.S. agricultural trade.

Signals given by the recent success of the NAFTA and GATT negotiations suggest that the world is moving down the "open-to-trade" path. But already there are signals from some countries that the political cost of adjusting to more open markets is forcing them to look for ways to limit their reforms.

—Jerry Sharples

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