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Roles for State Government in International Trade

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Foreign markets can provide new economic opportunities for agricultural producers. However, the costs of accessing those markets are beyond the capacity of many independent agents, while the benefits are probably too narrow to suggest a federal role. Because of environmental and historical differences, states have particular interests in specific commodities (e.g., Washington's apples, Florida's oranges, and Wisconsin's cheese). Thus, when independent agents lack capacity due to their small scale, it falls to the state to provide market research, technical support, and promotional activities to establish its producers in a foreign market. While the costs of such services are probably not warranted from the perspective of a single producer, they may be negligible compared to the long term gains to that state economy from dynamic trade relations.

As incomes rise, the percentage of income spent on food, in aggregate, declines. This relationship, known as Engel's Law, is possibly the most consistent economic pattern ever observed. A second common pattern in food consumption—Bennett's Law—holds that as incomes rise the share of "starchy staples" in the diet declines (Bennett, 1941). Together, these relationships explain many of the past transitions and current challenges in rural America. They also point to strategies for coping with economic stress in rural communities.

Over the last 50 years, the U.S. economy has evolved in keeping with Engel's Law. In 1950, total disposable income in the U.S. came to about \$190 billion and 20 percent of that total was spent on food. By 1996, disposable had risen to \$5,588 billion, while the share spent on food had fallen to 10 percent. With food and agriculture receiving a smaller and smaller share of total national income, it is not surprising that populations moved out of rural areas, that many rural areas were urbanized or sub-urbanized, and that many rural areas have not kept up, economically, with the rest of the country.

Engel's Law and Bennett's Law imply two possible directions for rural agricultural communities. The first is to seek out specialty markets domestically. While the share of income spent on food in aggregate will decline with economic growth, both absolute and relative spending on specialty items can be expected to rise. The second possible avenue for agricultural communities is to look abroad for growing food demand.

Whereas an additional dollar of income in the U.S. generates about 10 cents of increased spending on food, a dollar's income growth in poor countries can imply as much as 60 cents added food consumption. The areas with the greatest potential growth in demand for U.S. agricultural products are those poorer countries that are experiencing rapid income growth. In such regions one can expect a high share of added income to go to food, and also a transition from direct consumption of cereals to meat consumption and the consumption of higher value food products.

This pattern was demonstrated by consumption in East Asia in the 1980s. During this period of rapid income growth, meat consumption rose at almost 6 percent per year in East Asia, compared to 1 percent annually in the developed economies (IFPRI, 2000). With growth in meat consumption, feed demand swelled and grain imports rose dramatically. Imports of maize into South Korea rose from 2.35 million metric tons in 1980 to over 7 million in 1989; South Korea's imports of feedstuffs rose from 13 thousand metric tons in 1980 to 1.6 million metric tons in 1989, to 3.6 million in 1998.¹ Despite this growth in meat demand, meat consumption per capita in developing countries remains about 25 percent of that in developed economies, implying that there is room for further growth in those markets. Of course the relative decline in direct consumption of cereals is not met solely through meat

¹ All data on agricultural production and trade are from the UN Food and Agriculture Organization, www.faostat.org.

consumption. Fresh fruits and vegetables, oils and fats and processed foods also expand in people's diets as incomes grow. Rapid income growth in poor countries, therefore, can provide an expanding market for a range of agricultural products from raw grains, to convenience foods, to beverages.

While the international market provides opportunities for rural producers, there may be considerable risks and high costs to finding and capitalizing on those opportunities. Concerning the risks, economic performance in developing countries is highly variable and difficult to forecast. During the 1990s, the U.S. enjoyed average annual growth rates of 3.2 percent, one of the best peace-time performances in the country's history. By comparison, China recorded an average annual growth rate of 11.2 percent.² Chile, Ireland, Lesotho, Malaysia, Singapore, Sudan, Uganda and Vietnam all grew at over 7 percent per year during the period; and 12 more countries of Asia, Latin America and Africa recorded growth of over 5 percent per year on average. While these impressive growth rates suggest growing markets abroad, other foreign economies, especially the "transition" states of the former communist bloc, experienced rapid economic contraction; Moldova's annual growth rate averaged -12.6 percent, Georgia's was -12.8 percent and the Ukraine's -11.9 percent. While major international corporations can track international economic trends themselves, small businesses would benefit from state assistance to understand and interpret the uncertainties associated with different countries' economic outlooks.

Given a sense of which countries have strong growth prospects, considerable market information would be required to determine whether the specific products consumed in those countries are consistent with a state's comparative advantage. Despite its 11 percent annual economic growth, dairy products remain a small part of diets in China, leaving that country an unlikely market for Wisconsin cheese. Similarly, rapid economic growth in (Islamic) Sudan and Bangladesh probably does not translate into vibrant markets for California's wines or Iowa's bacon. Be that as it may, China's growth may have considerable implications for corn, wheat and soy producers who could help the country meet its growing feed and vegetable oil demands. Where a match between the products produced and those demanded is not in place, state sponsored research could determine whether a market niche might be created, or whether producers could supply a different product. An example of the later

might be shifting from yellow to white corn or marbled to lean meat production to meet the taste preferences in a foreign market. Shifts in product quality or destination are likely to be recurrent issues as third country suppliers enter markets over time. A state therefore has an ongoing role in providing information about market demand in foreign countries that is relevant for the state's producers, but comes at a cost which may be too high for individual agents.

Once a foreign country with an appropriate demand profile is identified, a state's producers may find considerable institutional barriers in the form of administrative regulations, commercial law, and contract enforcement. Interpreting the commercial law of a foreign country could be a costly task and the consequences of misunderstanding that law could be far more costly. A state government can reduce the total costs of navigating a foreign institutional structure providing liaison services, training, or consulting through a foreign trade office. These services are especially important when the export products are produced by small businesses that lack the relevant internal resources.

Finally, states can play an important role in establishing the presence of their producers in a foreign market. The costs of doing business with a particular counterpart tend to decline over time as relationships deepen and reputations are established. Consequently, early entrants into an emerging market can often defend a large share of that market as it grows. The role of promoting its products is probably most important in newly opening economies such as Vietnam, South Africa, or potentially Cuba. If a state's producers are among the first to establish trading relationships with agents in such countries, and if those relationships are mutually beneficial, suppliers from other countries will not easily break into the market. That implies both a payoff to aggressive promotion in specific markets and a long term cost of failure to enter markets in a timely way.

The market research, technical and administrative services, and promotional activities described here constitute costs of doing business that must be paid if rural producers are to access international markets. States that wish to promote economic development among rural communities that lack the capacity to pay such costs should find mechanisms to deliver support in these areas.

References

- Bennett, M.K. 1941. International contrasts in food consumption. *Geographical Review* 31: 365-374.

² All growth rates taken from World Bank Country Data, www.worldbank.org.