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THE EMERGING TRADE SITUATION FOR U.S. AGRICULTURE

by
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Introduction

The most important market changes for American agriculture in the past decade and a half have been those related to exports. These changes have had far reaching implications for how farm commodity and input market function and on the policy issues that emerge. Like the internal market, the international market functions in a changing, dynamic context. Changes in foreign demand, production and government policies, as well as weather continually work to alter the set of constraints and opportunities facing U.S. agriculture.

The implications of increased international involvement are profound. A range of countries have become dependent on U.S. supplies and American agriculture has become dependent of foreign markets. The trade position of U.S. agriculture is of national concern due to its implications for our overall balance of payments. The trade expansion of the 1970s was capitalized into land values and in turn the trade contraction in the 1980s has had a depressing effect on land values. Also there is an increased degree of instability that has become apparent, some of which related to fluctuations in international markets. Thus, these linkages between domestic and international markets are reflected in such areas as price formation, the degree of market instability that exists, the rate at which markets grow for different products, how income is distributed within the sector and a number of other aspects.

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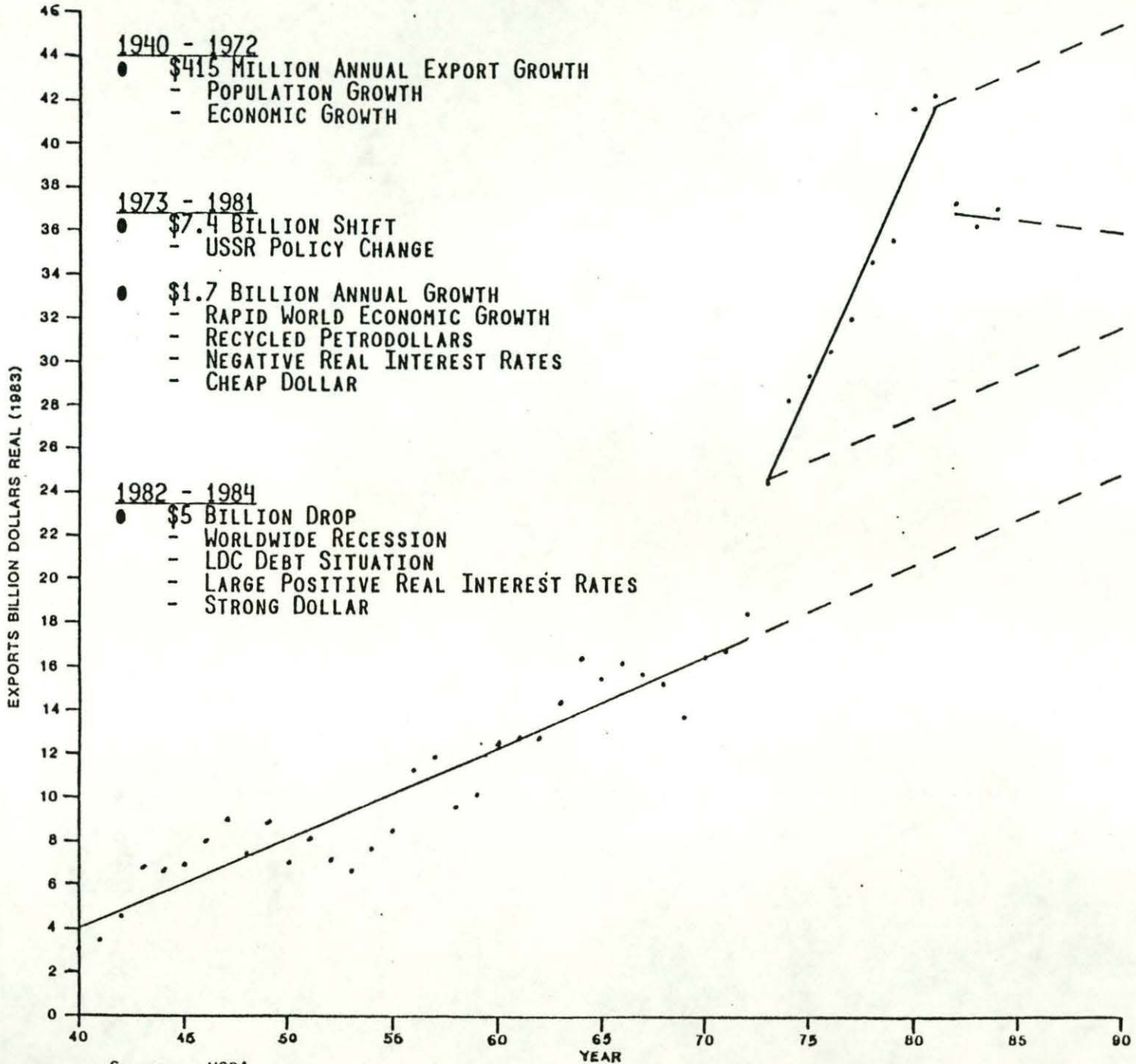
Background and Conditions

An indication of how international markets have affected American agriculture can be gained by looking briefly at historical patterns of change. Change since 1940 can be broken into three periods as indicated in Figure 1. From 1940 to about 1973 exports exhibited slow but steady growth based on population increases and sustained economic growth throughout the world. The bulk of this expansion was in exports to industrial countries in Europe and to Japan. Markets generally were stable with little variation about the trend line and exports in general were a marginal element for U.S. agriculture and were given relatively little consideration in formulating policy.

In the early 1970s, however, two fundamental changes occurred in the world economy. The world moved from fixed to floating exchange rates and this greatly increased the importance of international capital markets. Second, the first major oil price shock was provided by the OPEC countries. These two monetary phenomena were particularly important to less developed countries (LDCs) and in some centrally planned economies (CPEs). Money poured into OPEC countries faster than they could use it. This money, in turn, was recycled through international capital markets, particularly by U.S. banks to other LDCs. Commercial bank lending increased by approximately 20 percent per year throughout much of the 1970s and this stimulated relatively strong economic growth in LDCs and some CPEs. Consumption increased, often at the expense of accumulated external debt and at the expense of productive investment. At the same time, industrial countries followed expansionary monetary policies and generated strong economic growth. World gross product increased rapidly and from the viewpoint of U.S. agriculture this was especially important in the LDCs. Trade increased

Figure 1



Source: USDA

dramatically and the U.S. gained in part because it had the capacity to expand production due to acreage being withheld through price support programs.

The specific factors that created the export phenomena of the 1970s are the following:

1. Russia changed its policy to permit expanded consumption of livestock products and entered world markets with major purchases from the United States. This plus increased imports in other areas created an immediate upward shift in U.S. exports of 7.4 billion as shown in Figure 1.

2. OPEC countries had plenty of money to import including food.

3. Low and negative real interest rates (Figure 2) encouraged LDCs to borrow including for the purchase of food.

4. A cheapening dollar (Figure 3) gave the U.S. an export edge.

As a result of these changes, U.S. agriculture enjoyed an annual export growth of about $1.7 billion per year on average from 1973 to 1981. The peak level of exports in 1980-81 reached approximately $44 billion.

But then the bubble burst. Two principle changes occurred to bring this on. 1) The second oil shock in 1979 exacerbated an already near explosive inflation situation, and 2) the subsequent reaction in industrial countries to tighten money supplies to contain inflation especially in the U.S. sharply altered the general world economic picture.

This had several effects:

1. Inflation was sharply reduced but it left the world in an economic recession.

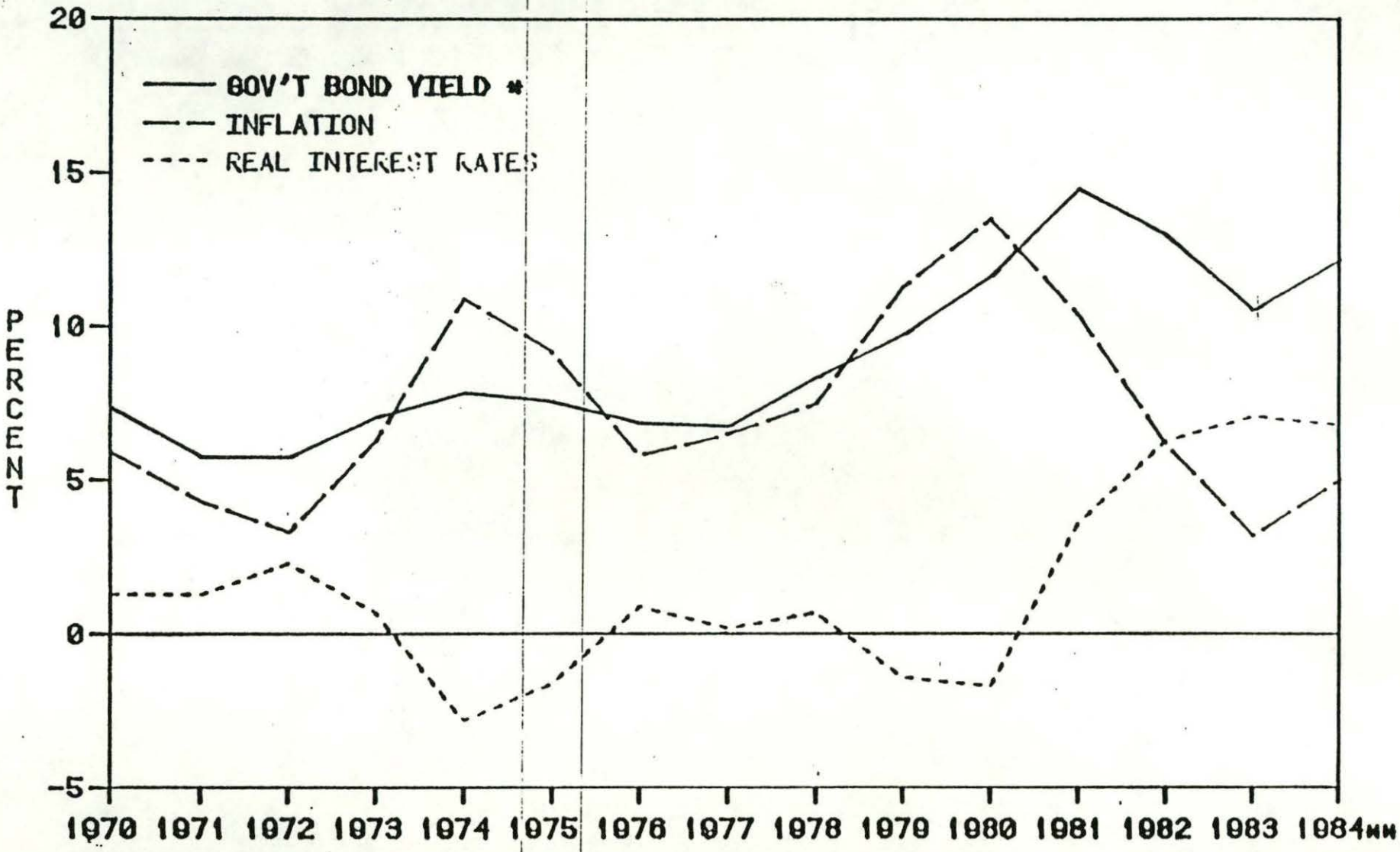
2. It caused commercial banks to drastically reduce lending to the point there is now a net outflow of capital from LDCs.

3. Real interest rates moved from low and negative to large and positive (Figure 3).

4. These changes caused severe financial stress in many LDCs as indicated by the fact that more than 40 countries have since

Figure 2

INFLATION, NOMINAL AND REAL INTEREST RATES IN THE UNITED STATES



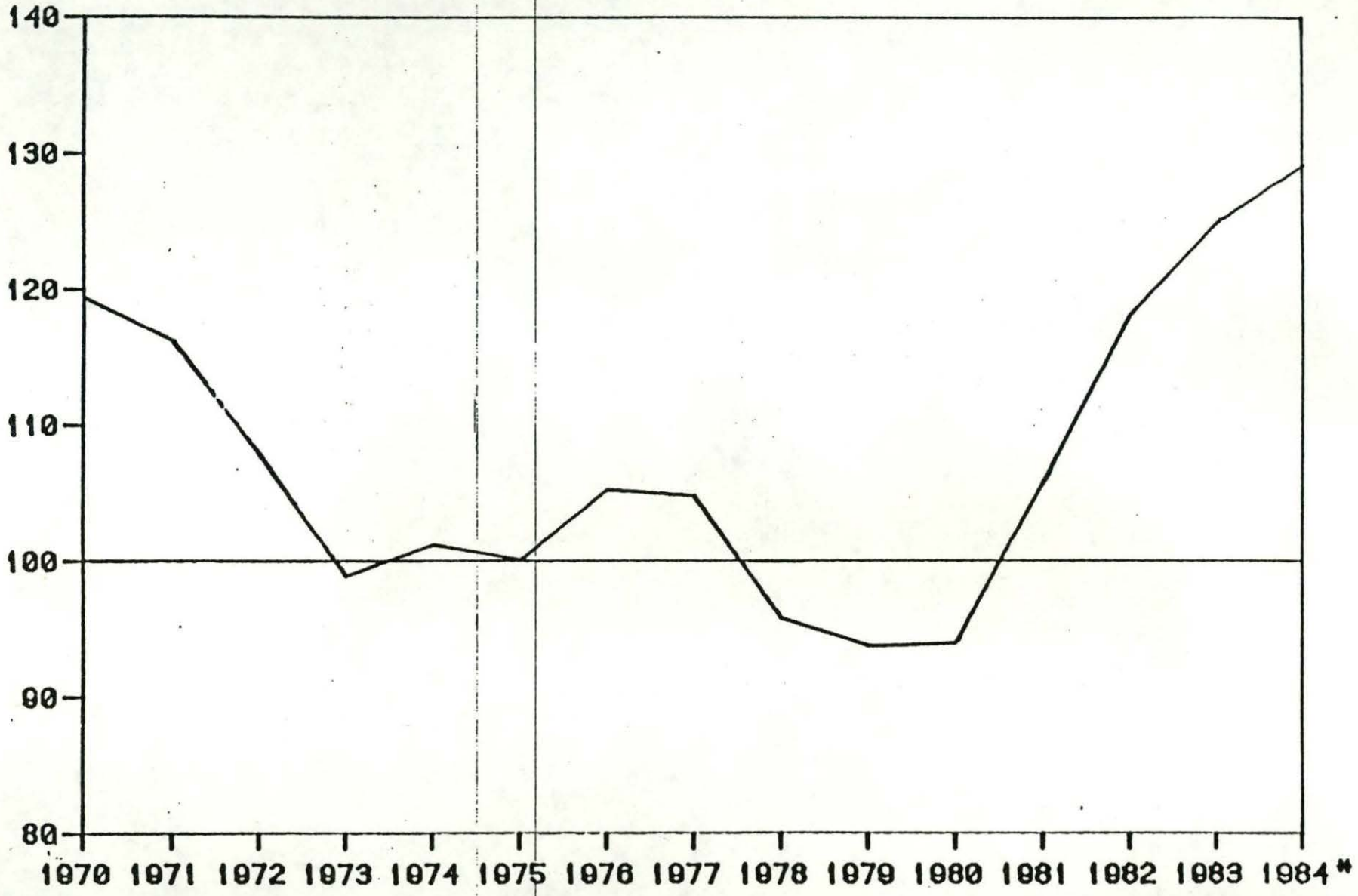
* MEDIUM TERM BOND

** FIRST QUARTER

Source: USDA

Figure 3

EFFECTIVE EXCHANGE RATE OF THE U.S. DOLLAR
1975 = 100



* FIRST QUARTER

Source: USDA

gotten behind in payments and have sought renegotiation of their debt.

5. World trade flows declined, including agriculture in total and a sharp drop in U.S. exports of approximately $5 billion in 1982.

6. This left the uneasy feeling that the world has changed in ways that we don't fully understand and may have difficulty coping with.

Within this framework the following appears to be the emerging and future trade situation for U.S. agriculture.

Short-term Prospects

Recent changes in U.S. agricultural trade present a mixed picture. The value of U.S agricultural exports during the first 9 months of fiscal year 1984 (Oct. 1, 1983 to June 30, 1984) rose by 12 percent to almost $30 billion. Based on this 9 month record USDA estimates that exports for the 1984 fiscal year will reach $38.6 billion up from $34.8 billion in fiscal 1983. This increase, however, is based on higher prices since total export tonnage of all commodities is expected to decline slightly from 144.8 million MT in fiscal 1983 to 143.7 million MT is fiscal 1984. Tonnages and values for the major export commodities for fiscal years 1983 and 1984 are shown in Table 1.

Table 1. Value and Volume of Wheat, Feed Grains and Soybeans (Millions of Metric Tons and Billions of Dollars) for fiscal years.

	1983	1984
Feed Grains		
Quantity	53.8	55.4
Value	6.7	8.6
Wheat and Flour		
Quantity	38.2	38.9
Value	6.2	6.3
Soybeans, Cake and Meal		
Quantity	31.8	26.3
Value	7.8	7.2

Source: USDA World Agriculture: Outlook and Situation Report, September 1984.

U.S. agricultural imports rose 20 percent during October-June and are expected to reach $18 billion in fiscal year 1984 up from $16.4 billion last year. Imports of sugar, coffee, cocoa and rubber increased, offsetting a decline in livestock and dairy products. Imports of vegetables and fruits were up through June, increasing by 12 and 18 percent respectively.

The export picture for the next year is uncertain. Total world grain production for 1984/85 is expected to reach a record 1.6 billion metric tons. Especially large production increases will occur in the United States where 1983 production was reduced by drought and the payment in kind (PIK) program. World grain trade in 1984/85 is expected to reach about 223 million metric tons, up 6 million tons from 1983/84. Most of the increase will occur in coarse grains.

The Soviet Union will have an important effect on the outlook for U.S. feed grain exports. USSR grain production for 1984/85 is forecast at 170 million metric tons. This is down from last year and 70 million tons below their goal fo 240 million tons. Total Soviet grain imports are expected to be 50 million tons in 1984/85 of which about half will be coarse grains. U.S. coarse grain sales to the USSR have increased sharply in recent months. This strong Soviet demand plus modest increases in the more rapidly growing Asian countries should lead to a small increase in U.S. coarse grain export tonnage in 1984/85.

World wheat production is expected to rise by more than 2 percent from last year. Exports are likely to be down in both Canada and Australia due to drought reduced crops and low beginning inventories. EC exports, however, could rise because of a large crop due to yields 15 percent above their previous record and some increase in acreage. The level of EC exports will

depend in part on whether they decide to export above their self imposed limit of 14 percent of world trade and whether EC exports can be made without export subsidies due to the high value of the U.S. dollar. In balance, however, U.S. export quantities should increase slightly in 1984/85.

World oilseed production in 1984/85 is projected to reach a record 186 million tons due to continued expansion of production outside the United States from reduced production in 1983. Soybean production is expected to reach 94 million tons in 1984/85 up 17 percent from last year. Slow economic growth in a number of countries with resulting weak livestock feed demand means that overall growth in meal usage will be small. Lower meal prices relative to 1983/84 could mean some increase in use based on price relationships between soybean meal and other feeds. This could lead to a small improvement in the quantity of U.S. soybean exports in 1984/85.

The overall prospects for U.S. exports in 1984/85 is for a modest increase in overall export tonnage. An anomaly will occur in that this modest growth in export quantities likely will be more than offset by lower prices resulting in a value of exports below 1983/84.

Longer Term Prospects

The longer term agricultural trade outlook reflects both positive and negative elements. On the positive side, world economic growth is on an upward trend. Growth in 1984 will probably reach 3 percent, up from 0.3 percent in 1982 and 1.9 percent in 1983. However, this overall growth rate is heavily weighted by the unexpectedly rapid recovery in the U.S. and substantial improvement in several other industrial countries. Growth rates in the developing world are expected to rebound somewhat but will continue to be well below the rates of the 1970s.

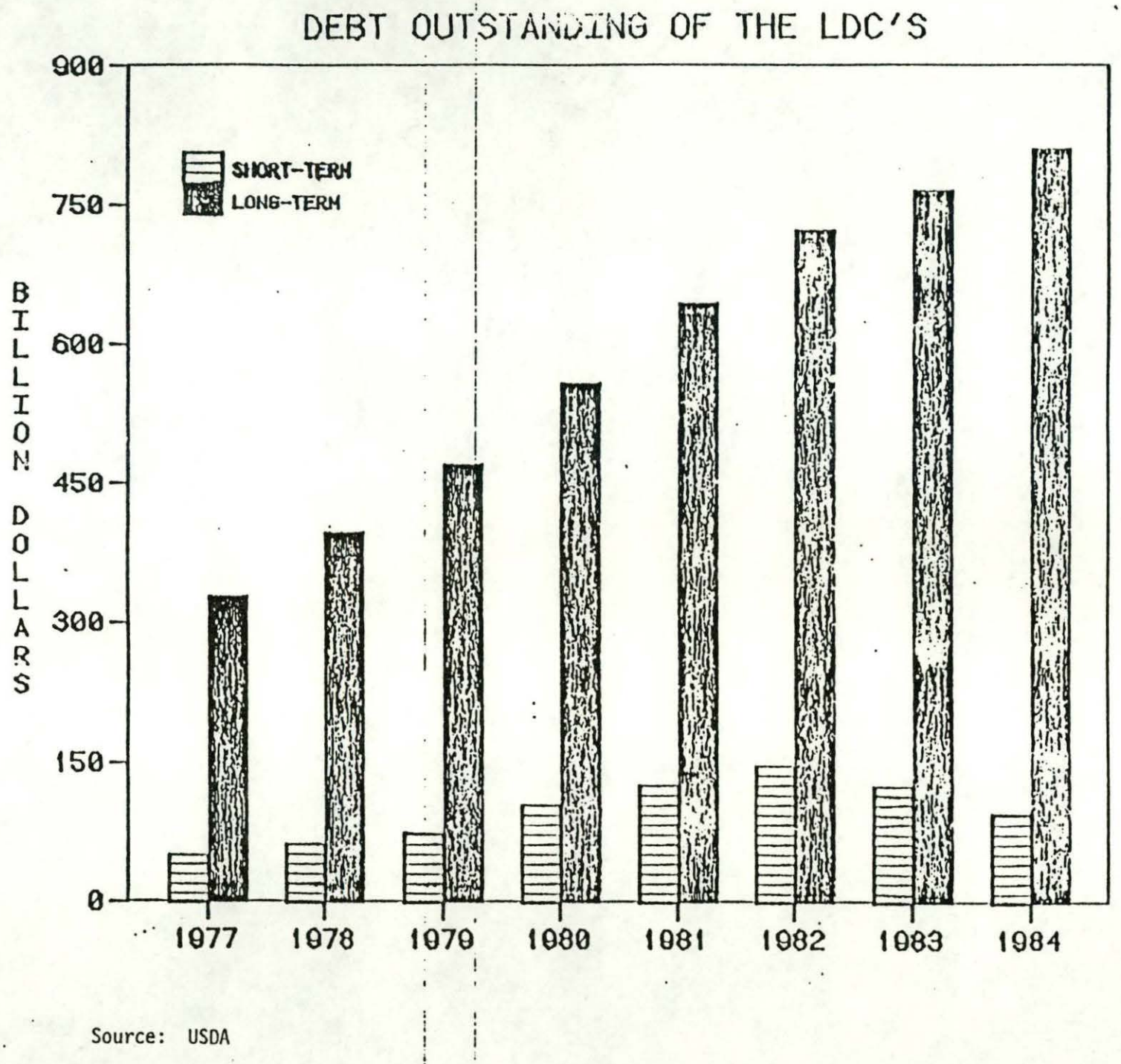
International financial conditions will continue to represent a negative aspect of the trade outlook. The expected decline in the value of the

U.S. dollar has not materialized. The strong dollar means that U.S. commodity prices are relatively high when denominated in foreign currencies and will have a dampening effect on purchases in many importing countries. Also, since world wheat, coarse grain, and soybean trading prices are denominated in U.S. dollars, the export prices of major competitors will remain high in their local currencies. A consequence of these price relationships has been to stimulate production in competing export countries, particularly Canada and Australia. The incentive for expanded output will remain unless currency realignment occurs and the U.S. dollar declines relative to the currencies of these countries. Consensus is emerging that this will not occur soon.

The other negative aspect of the international financial situation is the increasingly stringent financial picture facing many LDCs. The total external debt of LDCs has reached about $900 billion (Figure 4). Despite this increase in total debt, some recent improvement has occurred in debt service ratios (Figure 5). This has occurred because some countries have succeeded in rescheduling short- and medium-term loans in to fewer longer-term loans with longer maturities. This means that repayment requirements in the near term have been reduced.

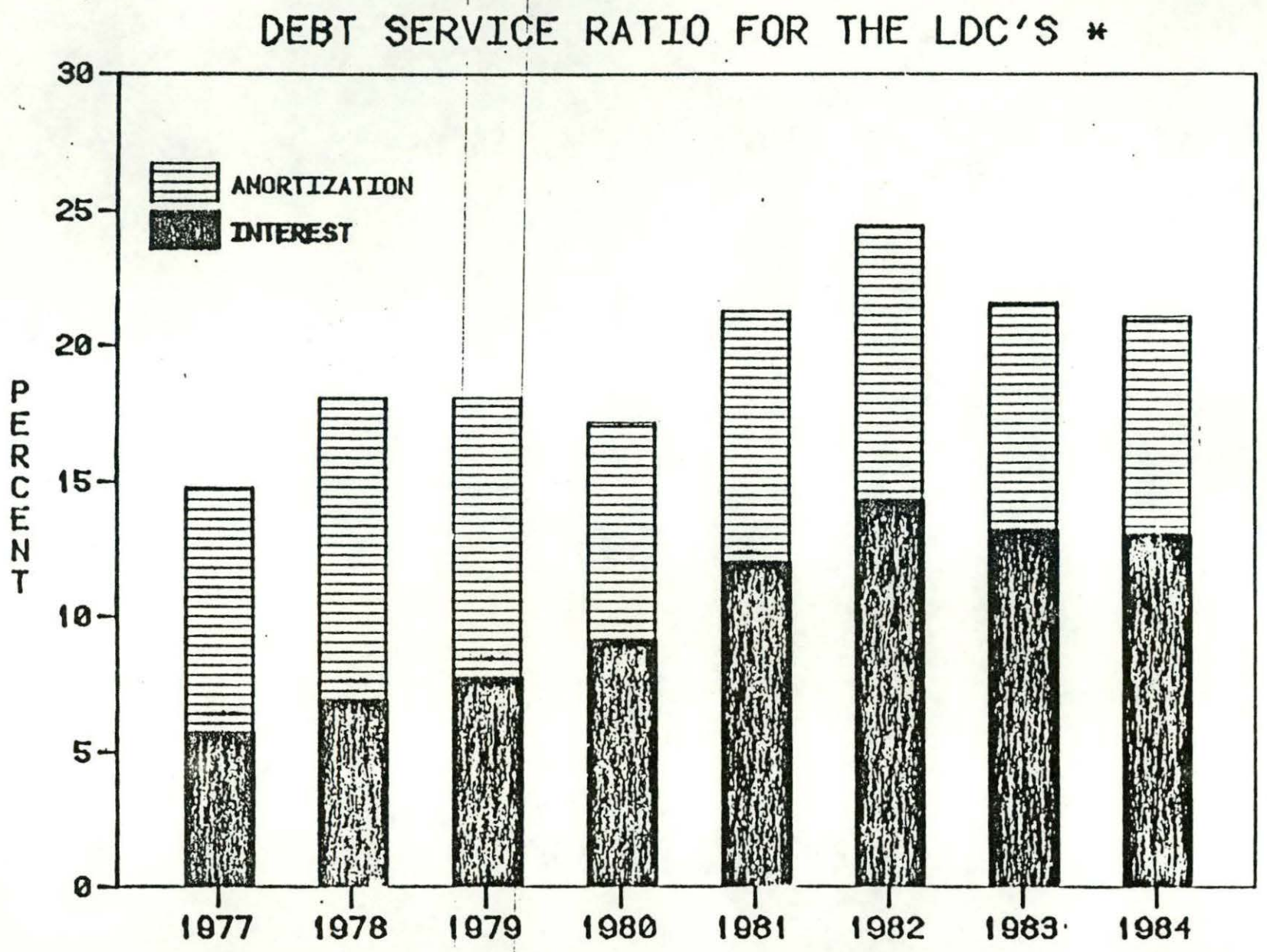
While this change will ease the immediate burden on some countries in the short term, it is not likely to have a dramatic effect on their imports of farm products. Debt service requirements are still heavy for many LDCs. The need to use large proportions of foreign exchange earnings to service debt will continue to inhibit imports needed to stimulate economic growth. Further, since loans are made to developing countries in foreign currencies, they must be repaid in these currencies. This can be achieved only through export earnings. This could stimulate renewed export drives in some LDCs, resulting in expanded exports of commodities competitive with U.S. farm

Figure 4



Source: USDA

Figure 5



Source: USDA

exports. This clearly is possible and can be expected in South America where the heaviest debt burdens exist.

Within this framework of improved rates of economic growth, continued heavy debt service burdens for many LDCs, and a strong dollar that will maintain price incentives for competing exporters and price disincentives for importers, our most recent forecast using the M.S.U. Ag. Model is that U.S. exports will increase only slowly and will not reach their historic highs until late in the decade (Table 2). These slow growth rates will be reflected in farm prices (Table 3). Following rapid export growth in the late 1970s and reduced crops due to drought in 1979, real farm prices reached a highwater mark in 1980 that will not be duplicated in the near future. The conclusion is inescapable that the 1970s represented an unusual period of market induced prosperity for American agriculture that will not soon be repeated.

Table 2. U.S. Wheat, Coarse Grain and Soybean Exports 1980-82 and Forecast 1983-89 (Millions of Metric Tons)

Year	Wheat	Coarse Grains	Soybeans
1980/81	42.0	68.9	25.5
1981/82	48.8	58.2	31.0
1982/83	40.0	53.6	30.6
1983/84	38.8	55.5	25.6
1984/85	40.1	60.9	27.7
1985/86	39.8	62.8	28.7
1986/87	40.1	68.0	29.8
1987/88	40.7	70.9	31.7
1988/89	43.8	73.3	32.6
1989/90	46.7	78.2	33.3

Source: M.S.U. Ag. Model, Long-term Forecast of U.S. and World Agriculture, Spring 1983

Table 3. U.S. Wheat, Corn and Soybean Farm Prices in 1983 dollars, Actual 1980-82, Forecast 1983-89

Year	Wheat	Corn	Soybeans
1980/81	4.72	3.76	9.14
1981/82	3.99	2.73	6.61
1982/83	3.66	2.76	5.82
1983/84	3.50	3.25	7.89
1984/85	3.34	2.71	6.94
1985/86	3.53	2.64	6.71
1986/87	3.48	2.48	6.41
1987/88	3.56	2.53	6.31
1988/89	3.58	2.57	6.41
1989/90	3.64	2.58	6.42

Source: M.S.U. Ag. Model Long-term Forecast of U.S. and World Agriculture, Spring 1983.

Programs and Policies

Finally the question needs to be raised as to whether marketing or policy actions can be taken to improve the U.S. trade picture. Three major government programs have been underway for some time. One of these is the extension of commodity credit corporation (CCC) credits to foreign buyers. Over time this program has included direct lending and the guaranteeing of credit extended by commercial banks. In recent years, only the credit guarantee program has remained operational, but the available funds have increased from about $1 billion to the current level of $5 billion annually.

A second thrust is market development. This program involves joint industry-government sponsored overseas promotion activities of various kinds and providing technical advise on preparation and use of products

based on imports from the U.S. More than 100 of these cooperative programs have operated since 1954. At present 50 agreements representing 76 commodity associations are operational. They involved a federal budget outlays in fiscal 1984 of approximately $31.6 million. This represents approximately one-third of total market development outlays. Cooperating groups (i.e. the American Soybean Association) spent in excess of $60 million on these programs in 1984.

A third existing program is international food assistance through PL-480. Since 1954, over $33 billion of U.S. farm commodities have been shipped to other countries under this program. While PL-480 has declined in relative importance compared with commercial sales, it still represents a significant add factor to total exports and potentially can be expanded.

Other ideas have been suggested to expand and stabilize U.S. agricultural exports. One of these is that the United States should enter into long-term supply agreements with major importing nations with a view toward locking in markets and putting the U.S. on an equal footing with other major exporters who currently enter such arrangements through their export marketing board. Another suggestion is that the United States should enter into a cartel arrangement with other exporters and participate in the management of international grain markets, both in terms of allocating quantities and in establishing prices. The problem with these suggestions is that each would require a great deal of control over U.S. domestic production and sales and probably the establishment of a single U.S. export agency to handle trade. It is doubtful that the United States is philosophically or politically ready for this kind of an institutional change.

Another suggestion is that the United States should more vigorously pursue efforts to reduce barriers to international trade. The European

Economic Community through its common agriculture policy, for example, supports farm product prices above world levels, and in turn protects itself from lower cost imports through a variable levy system. Japan protects its farmers, with even higher prices, through a system of quotas and administrative constraints on imports. Numerous other countries restrict imports in various ways and in total world markets are badly organized.

In the past, the United States has led two rounds of trade negotiations which included efforts to reduce barriers on agricultural trade. But this turns out to be difficult to achieve. Farmers in protected countries fight hard to retain the protection they have from foreign competition and despite the higher food prices that result, there is little organized consumer resistance to agricultural protectionism. Further, the question of agricultural protectionism is a two-edged sword and the United States is far from having a clean record. While we have recently sought reduced barriers to our exports, we have to live with the fact that we originally sought massive exclusion of agriculture from the rules of the General Agreement on Tariffs and Trade (GATT) in order to implement our own price support programs. This rule known as the Section 22 Excèption permits the United States to establish import barriers on commodities where imports would increase the cost of our domestic price support operations. Over time these exceptions have been important on a number of commodities and we continue to maintain exceptions for the dairy industry and recently added Section 22 protection for tobacco. In addition we maintain import protection on beef, sugar and a number of other items. Clearly, our own unwillingness to give up protection on a range of commodities creates a difficulty in seeking liberalized trading relationships in other countries on those products that we export.

A final set of policy concerns are those macro policies that keep the value of the dollar up and lead to calls for further import protection and our agricultural policies that affect the prices at which commodities are traded in world markets. The argument is being made that our current farm price policies create implicit export subsidies and that existing loan rates along with a strong dollar at least potentially can, and may already have, begun to price the U.S. out of world markets. This suggests the need to re-think our farm policies in the light of current conditions. I will not elaborate further on this point. It is the subject of my presentation this afternoon.