INTRODUCTION TO INTERNATIONAL TRADE

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Fundamental factors affecting international trade in agricultural commodities are addressed in this overview paper. Food commodities are emphasized although it is recognized that there is extensive trade in other commodities such as cotton, wool, tobacco, animal hides, and numerous other commodities that are not convertable into foods. Trade in foods, or materials converted directly or indirectly to foods, is unique because of the essential character of food for sustaining life as compared with other commodities.

Comparative Advantage and International Trade

Areas within a country and among different countries have advantages in production of certain commodities compared with other areas and countries. This creates conditions favorable to trade among geographic areas and countries.

The most obvious production advantages for food commodities are attributed to superior soils, rainfall and/or availability of irrigation water, favorable temperatures, humidities, and other natural attributes. Moreover, ownership or control of natural resources together with the existence of economic and political systems favorable to implementing superior technologies contributes to comparative advantage.

Temperate climates with moderate precipitation and relatively level, fertile, well drained soils have a comparative advantage in the production of cereal grains, oilseeds and forages. These conditions characterize much of the United States, especially the North Central Region. Warmer climates with longer growing seasons are favorable for producing cotton, tobacco, peanuts, and multicropping oilseeds and cereal grains. These conditions prevail in the Southeast and South Central United States. Frost free, or near frost free, climates are required for producing citrus fruits and are favorable for the production of other fruits and vegetables. These conditions generally prevail in the extreme southern and western fringes of the United States.

Tropical climates are necessary to produce bananas, coffee, cocoa, and numerous other fruits, nuts and vegetables. These conditions do not exist in the 48 contigous United States. Thus, these commodities are generally imported by the United States and add variety to diets.

The United States has a comparative advantage in producing cereal grains, oilseeds and forages, the major inputs in the production of animal products. However, other temperate areas of the world such as Europe, Canada, Oceania and Argentina, can and do produce these commodities in abundance. Also, much of the tropical and semitropical world can produce most food commodities with appropriate technologies. These areas must be recognized as potential U.S. competitors in the international trade of agricultural commodities.

Production Specialization and Trade

International trade is simply an extension of trade (exchange of goods and services) across international boundaries. Specialization in production greatly enhances labor (defined as expenditure of mental or physical effort) productivity and is the basic incentive underlying trade. Specialization exploits economies of size, including the use of large scale machines, mass production techniques, and adoption of emerging technologies. Without exchange or trade, specialization would not be possible. The alternative to specialization and trade is a subsistence society where each individual or family essentially produces what it consumes.

Specialization and trade enhances the creation and distribution of wealth, including food. Hunger, malnutrition, and limited variety in diets are common to those parts of the world characterized by a predominantly subsistence culture. Diets are limited to those foods that can be produced locally. A low level of labor productivity pervades these cultures. Moreover, subsistence cultures are highly vulnerable to adversities of weather, diseases and insects.

Advancement of civilization has paralleled increasing specialization and trade. Increasing specialization and productivity in food production releases agricultural labor to produce higher order goods and services that provide not only the necessities of life but contribute to comfort, convenience and pleasure -- enhancements to "quality of life." The more affluent countries of the world including the United States, Canada, western Europe, Oceania and Japan have a relatively small proportion of their labor force in agriculture. These are the countries with an abundance -- as measured by quantity, quality and variety -- of foods affordable to most of the people.

The wealth of a society is measured by the creation and distribution of goods and services that enhance quality of life. Natural resources (soil, water, fossil fuels, air and minerals) knowledge, skills, tools, machines, technologies and personal initiative are the required ingredients for creation and distribution of wealth. However, knowledge, skills, machines, tools and technologies are also created by personal initiative. In essence, people create wealth from the raw materials of nature. Although foods exist in nature, most of the foods consumed by people are created by people and in the highly developed world most foods move in commercial channels.

Money and International Trade

To avoid the inconvenience of direct barter, people created money to expedite trade and serve as a store of value. Money expedites the capitalistic system through the production of intermediate goods and services. Capitalistic systems require postponement of consumption (in part) with the expectation of enhanced consumption in the future. Accumulated money -- savings -- represent future wealth. Savings are invested in intermediate goods and services used in further production, and/or in inventories of goods for future consumption. Confidence in the monetary unit retaining its value over time is essential to the system. Interest on money lent includes both an incentive to postpone consumption and compensation for the risk of money losing purchasing power.

Most, if not all, national governments issue their own currency (money). This becomes one of the major constraints to international trade. International traders in one nation assemble commodities, paid for in their local currencies, with the expectation of selling to other nations in the currencies of those nations. The final outcome (profit or loss) in international trade is not fully realized until the foreign currencies acquired in trade are exchanged again for the local currency. Thus, there is a dual risk in international trade -- one is the risk of a relative change in the value of the commodity and the other is the risk of a change in relative currency values. However, risk embodies the potential of windfall gains as well as losses. The dual risks inherent in international trade include the prospects of off-setting changes in the commodity and currency values, or prospects of compounding gains or losses. As a result, there is greater risk in international trade than in domestic trade.

Monetary Policy and International Trade

Two abrupt changes in United States monetary policy during the 1970s had a substantial impact on international trade, especially agricultural commodites. More specifically, the volatility in monetary policy together with existing domestic farm programs greatly affected agricultural exports. Thus, farm policy formulation cannot be independent of other public policies.

The change in monetary policy implemented in August 1971 had a very pronounced positive impact on agricultural exports. Prior to August 1971, foreign dollar holders could exchange dollars for gold at the rate of $35 per ounce of gold. The value of the dollar was, therefore, guaranteed by the U.S. government at 1/35 of an ounce of gold. However, due to the excessive drain on gold during years prior to 1971, the United States ceased to exchange gold for dollars. This act, in effect, floated the value of the dollar in terms of foreign currencies. Subsequently, the value of the dollar fell relative to other currencies and made United States agricultural commodities cheaper in terms of the currencies of importing countries. Because domestic farm support prices were pegged to nominal or U.S. dollar values, prices to domestic producers were more attractive in the export market than in the U.S. market.

Another change in United States monetary policy, implemented in October 1979, had a negative impact on agricultural exports. This was a policy of targeted (limited) money growth in the United States in an effort to constrain price inflation. Subsequently, interest rates in the United States rose to unprecedented levels and so did the value of the dollar relative to major foreign currencies. This, in effect, increased the price of United States commodities in terms of the currencies of importing countries.

These changes in monetary policies had, of course, opposite effects on U.S. imports. Although we tend to emphasize the importance of exports, imports are both necessary to sustain exports and to enhance the quality of life in the importing country. Some U.S. food imports -- such as beef and sugar -- compete with domestic production. Other food imports -- such as bananas and coffee -- generally compliment domestic production.

Political Instability and International Trade

Wars -- hot and cold -- and an array of lesser political confrontations around the globe seriously impede international trade. This is especially true of foodstuffs since food is essential to national security. Most countries have policies directed toward self-sufficiency in food -- at least the basic foodstuffs. This policy often prevails even where domestically produced foods are substantially more costly than imported foods.

Some countries also intervene in international food trade in efforts to stabilize prices in and encourage local production for the domestic market. This may take the form of subsidies in case of shortages in domestic production. When surpluses are created by government support of prices to domestic producers, subsidies on exports may also be used. This is labeled by competitors as an unfair trade practice. However, it is not possible to control, over time, both price and quantity of commodities moving in international trade, as recently evidenced by weakening of the OPEC oil cartel.

All markets are interconnected in some fashion and efforts on the part of some countries to stabilize prices simply contribute to price instability elsewhere. Efforts of the United States government to support prices to domestic producers through production controls and farm price subsidies provide an incentive for foreign competitors. This happens when U.S. domestic prices rise above world market prices. The result is surplus domestic supplies and loss of export markets.

While the United States is a net exporter of foodstuffs, its full potential as a food exporter has not been fully realized. World political and monetary stability so necessary to fully exploit international trade potential have not yet materialized.

A series of events during the years 1971 through 1974 created a highly volitle international trade in food commodities. These events include: 1) devaluation of the U.S. dollar and the elimination of the international gold standard, 2) weather related short falls in food supplies over much of the world, 3) massive U.S. grain sales to the Soviet Union, 4) the beginning of the oil crisis, 5) the most severe price inflation in the U.S. since the Civil War. Another series of events during 1979-83 adversely impacted international trade in food commodities including: 1) a drastic change in U.S. monetary policy creating high interest rates and a rising value of the dollar, 2) a U.S. embarge on shipments to the USSR, 3) an emerging oil glut and falling oil prices, and 4) world wide recession and monetary crises.

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