

INTERNATIONAL TRADE POLICY: CHALLENGES AND OPPORTUNITIES FOR U.S. AGRICULTURE

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The time when farm producers and agribusinesses could ignore the world beyond the county line and hope for a profit is long past. Rapidly changing events such as changes in the geopolitical structure of regions are altering production, consumption and trade patterns. International trade policy is also evolving to reduce subsidies and barriers to trade and, in some cases, create artificial advantages in the global market.

Such actions have already brought challenges of maintaining profitability or basic survival to U.S. agriculture. Producers, agribusinesses and public service and support agencies (including land-grant universities) will be put to the test over the next decade as the world around them forces change. Agriculture and its institutions will sustain themselves, but the forms they take are by no means certain. The purpose of this paper is to identify some of these challenges as well as opportunities available to the U.S. agricultural sector and related institutions.

The key challenges to U.S. trade policy this decade will be to 1) determine the level of “free” trade we are willing to promote; 2) determine what price we are willing to pay for free trade; 3) position our industries for changing opportunities in a rapidly-evolving global market; and 4) anticipate government and multinational power relationships in this global economy.

The major challenges of U.S. domestic policy in the 1990s will be to 1) design domestic price/income support policy tools that pass a General Agreement on Tariffs and Trade (GATT)-type test of being trade neutral or at least less trade distorting than in the past; 2) move the public social agenda forward to address environmental, quality of life, food safety, and equity concerns without unduly reducing the competitiveness of U.S. producers and firms; and 3) invest in state-level activities that address the localized effects of global events and trade policy.

As trade liberalization is increased through such actions as GATT and the North American Free Trade Agreement (NAFTA), comparative advantage will increasingly determine production decisions, putting some countries in a position to be more competitive than others on certain goods and services. Federal budget cuts will accelerate this change. While such advantages may be natural-resource-based or developed with human capital, infrastructure or institutions, trade liberalization is intended to reduce artificial advantages created by institutional arrangements such as government intervention.

Global Events

The United States is a leading exporter of grain and the export market is likely to remain a significant factor in maintaining/improving conditions in U.S. agriculture. While the U.S. nonagricultural trade deficit continues, various factors have combined to improve U.S. agricultural market share in the global economy, as well as a recent significant improvement in nonagricultural trade. These factors include a depreciating dollar, export support programs, more competitive prices, and bilateral agreements to liberalize trade barriers. The debt crisis of third world countries remains a problem, although some analysts see improvements in sight. There is uncertainty over the potential impact of the European Community (EC) power bloc that became more singular in 1992. Additionally, the geopolitical restructuring in Eastern Europe and the former Soviet Union will change trade flows and make economic predictions even more difficult.

Firm-level competition on a global scale is of increasing importance to agribusiness. Agricultural exports represent one of the few sectors that has maintained trade surpluses during the past two decades. Focusing on value-added products, of which processed meat and poultry are a part, their export value has increased from about 30 percent of total bulk and of value-added exports in the early 1980s to 42 to 45 percent in the late 1980s. In 1989, more than \$17 billion in value-added agricultural products were exported. The growth in processed food exports has been tied to economic growth in other countries. Linking this trend with the geopolitical changes in Eastern Europe and the recent and ongoing economic growth in Mexico and

Table I. U.S. Trade Balance, Agricultural and Nonagricultural, Fiscal 1979-1991

	1979	1981	1983	1985	1987	1989	1991
	----- \$ BILLION -----						
Agricultural	15.8	26.6	18.5	11.5	7.2	18.1	15.0
Nonagricultural	-41.6	-52.0	-71.3	-134.5	-164.5	-139.8	-107.0
Total	-25.8	-25.5	-52.8	-123.0	-157.2	-121.7	-92.0

Source: U.S. Department of Agriculture

other less developed countries (LDCs) suggests a window of opportunity for firms which have the ability to be competitive.

For example, preferences for meat and poultry in Eastern Europe and Mexico have been growing rapidly. While domestic production experienced similar increases, pork imports to these countries more than tripled during that period. Broiler meat consumption in Mexico has grown threefold from 1973 to 1991. Broiler meat imports for that same period in Mexico is more than 18 times greater. Mexico's beef and veal consumption also grew nearly five times from 1960 to 1991. Mexican beef and veal imports are fifty times greater just since 1973.

While much of Eastern Europe's meat and poultry needs are provided by intra-country trade, consumption has risen significantly there in the past few decades and the potential for competing in market niches remains untapped. Pork consumption in Eastern Europe grew three times from 1960 to 1991. Pork imports for this region are 45 times greater for that period. Eastern European broiler meat consumption increased 12.5 times from 1969 to 1991, while imports grew eight times just since 1975. Beef and veal consumption in Eastern Europe expanded more than two times from 1960 to 1991, while imports grew nearly three times for the same period.

The explosion in preferences for meat and poultry in these countries indicates real potential for competitive processors. As these countries reorient their economies and begin to experience increases in discretionary income, export companies can position themselves for opportunities if the policies of those countries maintain an open trade door.

Companies/products that are likely to benefit from EC92 include raw commodity and processed products from food and feed grains, dairy, peanuts and tobacco. The uncertainty with the beef and poultry markets will depend upon the EC policies and attitudes regarding animal rights and chemical additives. U.S. producers may have to decide between playing by EC rules or walking away from that market. Large corporations such as Cargill and ConAgra that can make such shifts and manage a European marketing strategy are likely to benefit. Individual producers may find increased opportunities for contract marketing of tailored products such as organic crops or chemical-free meat. The Japanese models of joint ventures and investment in progressive European food and fiber processing firms with continental distribution networks may also pay off, although the short-run impacts on the U.S. trade deficit could be troublesome.

Recent Trade-Related Actions

The Food, Agriculture, Conservation & Trade Act of 1990 (FACT90) was a unilateral action by the United States that moved the United States closer to what it had hoped other countries would

agree to in GATT negotiations. Mandated flex acres for commodity program participants reduced the potential price and income support and increased the opportunity for producers to get market signals more directly. Relaxed rules for buffer stocks policy (the Farmer-Owned Reserve) also offer increased opportunity for market-, rather than government-induced, decisions. FACT90 generally continues the unilateral market-oriented move which began with the 1985 farm act.

Examples of multilateral policy include the U.S.-Japan Beef and Citrus Agreement, the U.S.-Canada Free Trade Agreement, NAFTA, the European Common Market and EC92, and GATT. Such institutional arrangements that result in liberalized trade rules can bring consumers lower prices or producers higher prices, a greater variety of goods, improved quality of products, improved resource allocation, a loss of some producers and related agribusiness, expanded business opportunities for firms, tax relief for the general public, and overall expansion in economic growth and income.

While multilateral negotiations are most often conducted to reduce distortions to trade, that may not always be the case. For example, countries may form trade blocs to counter market power of other countries or blocs. The trade bloc may reduce barriers to trade within the bloc, but maintain or increase barriers between the bloc and other countries. Some analysts have suggested the Single European Act of 1992 (EC92) will maintain/increase barriers for non-EC countries—the so-called “Fortress Europe” concept. The NAFTA will likely not result in a “Fortress America,” although there will be more favorable terms of trade among the United States, Mexico and Canada. Ironically, the countries that are warning of a “Fortress America” are the same countries (notably Japan and the EC) that are reluctant to accept U.S.-Gatt proposals similar to NAFTA.

Quotas, embargoes, quarantine regulations and a host of other nontariff barriers will remain in the agricultural sector, but probably at reduced levels. Even so, as tariffs are lowered and quotas removed, the frequency with which sanitary and phytosanitary regulations are used to restrict trade are likely to increase. The reduction of nontariff barriers, especially health and phytosanitary regulations, is a major task for upcoming negotiations.

Under NAFTA, lower tariffs in Mexico are likely to especially benefit U.S. high-quality beef and poultry, dairy products and wood products. Duties on one-half of all U.S.-Mexico agricultural trade will be eliminated immediately. Other tariffs will be phased out over a five- to fifteen-year period. Most U.S. imports of feeder cattle come from Mexico. Mexico is the second largest buyer of U.S. meats, although there is a Mexican tariff of 10 percent to 20 percent on pork. Beef enters the Mexican market duty free. Much of these exports to Mexico are composed of offal, with boxed beef and fresh, chilled or frozen meat expanding in recent years. Meat purchases by

Mexico would likely increase with NAFTA. More Mexican feeder cattle may move into the United States, having a marginal effect on U.S. feeder cattle producers. Mexican purchases of U.S. dairy cattle will likely increase.

Harmonization of health and sanitary regulations would increase trade flows, while maintaining an agreed-upon standard of safety. In 1990, the Mexican government began a three-year program to phase out the feeder cattle export tax, which was eliminated on September 1, 1992. There are some differences regarding the impact of these cattle movements. The United States imported just over one million Mexican feeder cattle in both 1990 and 1991, while imports were 30 percent below those levels for the first six months of 1992. Most of the feeder cattle end up in feed lots in southwest Texas and the southern plains of Texas and Oklahoma. In 1990 and 1991 fewer than 160,000 head were returned to Mexico for slaughter. If these feeders displace feeders coming from U.S. cow-calf operators, that domestic activity will shrink somewhat as producers experience lower prices and returns. It has been estimated in a recent study at Texas A&M University that Mexican feeder imports actually lowered prices by \$.07 per pound for a 500-pound steer in 1990. The feeders that are light enough to go as stockers onto wheat pasture are a benefit to rental rates and hold stocker prices down.

Grains and oilseeds account for about two-thirds of the tonnage of U.S. agricultural exports to Mexico. Mexican import licenses or quotas on most U.S. exports will be terminated with NAFTA. Both countries also have domestic farm programs that affect trade. NAFTA requires no restrictions on domestic farm programs and essentially does little to reduce export subsidies. The lack of good arable land puts Mexico at a comparative disadvantage. U.S. agriculture has the advantage in natural resource base, marketing/distribution infrastructure and agribusiness support. U.S. processors are typically larger and lower cost producers than Mexican processors. Although Mexican processors have access to cheaper labor, labor is typically a small percentage of production costs. Too, U.S. processors are usually more efficient than those in Mexico. Poor rail and storage infrastructure also harms Mexico's competitive position.

A common problem that occurs in the negotiation and implementation of trade agreements is the compromise to assure a balance with which countries with different political agendas and constituencies can live. For example, there are concerns among U.S. wheat and livestock interests that the NAFTA will sell them short for gains in other sectors. The wheat and livestock industries fear that Canada will be allowed to continue transportation subsidies that permit the Canadians to compete at Mexican border prices. The livestock industry also has a concern about rules of origin. The potential for serious competition from the Mexican livestock sector is marginal at best, but could be enhanced if cattle could be imported from other

Latin American countries. However, this alternative also has limited potential given the high incidence of aftosa and other tropical insect and disease problems, along with higher transport costs.

A study partially funded by the American Farm Bureau, and completed prior to agreement, shows a NAFTA could bring U.S. gains in grains and oilseeds; livestock products including low-cost process meats, edible offal and high quality beef and pork, cattle and hogs; dairy products; processed cotton through textiles; forest products; seasonal fresh vegetables during spring and fall; selected fruits. U.S. losses may come in apparel, fruits and vegetables. U.S. Department of Agriculture (USDA) studies of a NAFTA show U.S. gains for grains, oilseeds and most livestock and products.

The U.S.-Canada FTA allows increased access to Canadian markets for fresh fruits and vegetables, poultry and eggs, and wine and distilled spirits. U.S. beef producers will see more gains, if Canada is forced to reduce transportation subsidies, thus improving the U.S. competitive stance. There is some speculation by U.S. wheat industry spokesmen that there has been and will continue to be some adverse impacts to U.S. wheat producers, at least in the short run.

The 1988 U.S.-Japan Beef Citrus Agreement improves access to the Japanese market. Since then, beef sales to Japan have more than doubled. Market access for fresh oranges was expanded to 22,000 tons by 1991 and thereafter allowed open access subject only to a 20 percent tariff. Reductions in tariffs on grapefruit, lemons, frozen peaches and nuts have occurred since then. The increased export demand has helped support domestic prices in the United States.

State and Regional Impacts of Multilateral Trade Liberalization

In one of the few studies of regional impacts that has yet been conducted, Sigalla evaluates agricultural sectors by state based on the level of protected and supported commodities. Assumptions of the study include:

- Subsidy and protection policies distort prices and result in resource misallocation, but cuts could push prices and output in different directions with uncertain outcomes.
- Reductions of subsidies and trade barriers would cut food costs and increase gross domestic product; while farm prices would increase in the short run, increased efficiency from long-run competition would mitigate price increases.
- Comparative advantage would rule specialization decisions, changing key production areas.
- Freer trade would increase the cost of production for formerly subsidized enterprises.

Sigalla's analysis is based on the findings of Roningen and Dixit that freer trade would bring much change in the composition of U.S. production and little in aggregate output. Sigalla uses the value of state agricultural production in 1987 multiplied by Roningen and Dixit's expected changes in income from free trade. The Sigalla results do not necessarily agree with other studies that have been conducted more recently, especially for NAFTA.

Commodity impacts include the following: Income falls for food and feed grains, sugar, dairy, cotton, rice, soybeans and possibly vegetables. Income from livestock, and possibly most fruit, would increase. Farm income would decline in most states, with the greatest declines in states that are major producers of sugar, rice or other program crops. If, however, 60 percent or more of the state's agricultural income comes from livestock production, there would be little or no negative impact and some states would see net gains.

In the Sigalla study, fourteen states that would reduce agricultural income significantly are major producers of program or protected crops (e.g., sugar cane, sugar beets, etc.) and low livestock production. Declines greater than 20 percent in agricultural income would occur in Hawaii, Louisiana and North Dakota. Crop income losses would overwhelm livestock gains in North Dakota and Montana.

Six states that would see little or no effect on agricultural income are Kansas, Massachusetts, New Jersey, Oklahoma, Rhode Island and Virginia. Livestock income accounts for more than 60 percent of agricultural income in Kansas and Oklahoma. While program crop income would decline, increased livestock income would compensate.

Six states with significant livestock sectors could benefit from freer trade: Colorado, Nevada, New Mexico, Utah, West Virginia and Wyoming. The remaining twenty-four states derive less than one fourth of agricultural income from program crops, but the livestock incomes of most are also not large. Their incomes would drop 2 percent to 6 percent. The states that do have significant livestock incomes (Nebraska, South Dakota, Texas, Iowa, Missouri) will have their gains offset with large program crop income losses.

Income losses in the agricultural sector are not likely to cripple any state's economy. As resources move to other sectors, increased efficiency will mitigate losses. Most nonagricultural sectors will benefit, but the nonagricultural sectors tied to program crops will face declining incomes (i.e., cotton ginning, grain processing, apparel, transportation, warehousing, insurance and retailing).

While the results of this study are quite dramatic and thought provoking, at least two important caveats need to be mentioned. Quantitative studies of trade liberalization often are on shaky ground because the parameters of those studies were generated from historical data and relationships over periods of non-free trade, distorted

by governmental intervention. No one really knows what economic relationships would result from free trade in agriculture since it has never existed. Second, the Roningen and Dixit study used 1986 as the base year which reflects the highest level of support to U.S. agriculture on record. Certainly any major reduction in support would be grossly overstated by the study.

Additional studies of trade liberalization are urgently needed because there are numerous global events with short- and long-run impacts on U.S. agriculture. Some of the more notable examples include geopolitical change in the former Soviet Union and Eastern Europe. Third World debt, Hong Kong '97, destabilized Eastern Europe, Mideast tensions, African nations in political and resource-shortage turmoil, and China facing a future with a new generation of leaders. The pent-up demand in Eastern Europe and the Commonwealth of Independent States (CIS) in the short run will likely force efforts to rebuild infrastructure and provide basic needs. U.S. agriculture will benefit from this activity. Assistance will be a drain on Western resources, especially Germany, the EC, United States and Japan.

In the long run, developments will help these countries become stronger customers and make them more competitive in some agricultural production. The key questions will relate to the level of protectionism, the extent of participation in the EC, speed of economic reforms and inter- and intra-country stability.

Less developed countries (LDCs) were the fastest growing market for U.S. wheat and feed grains exports in the 1970s. However, LDCs built up debt far in excess of their ability to repay. The USDA has estimated exports to debtor nations for 1990 in excess of \$530 billion (1982 dollars). If there were no interest payments on debt, exports could be as high as \$900 billion for the same period, according to the USDA. Thus, the indication is that real growth, coupled with debt reductions in LDCs, will strengthen U.S. export sales, especially in agriculture. The USDA study specifically indicates U.S. agricultural exports are down about \$3 billion per year since 1982 because of the debt problem. In other words, agricultural exports could be as much as 8 percent higher if the debt crisis were not in existence.

Domestic Policy

The United States is not a free trade nation. Section 22 provisions apply import quotas for dairy, cotton, sugar and peanuts. The United States also uses nontariff barriers such as quotas and health and safety standards. Periodically formal quotas are instituted on commodities such as beef and peanuts to protect domestic producer prices. The United States has also made use of informal quotas for such goods as Japanese automobiles by only suggesting limits on imports, known as voluntary export restraints (VERs). Health and safety standards have taken on increasing importance in recent years.

The federal government both subsidizes and restricts U.S. domestic industries. Subsidies come in the form of tax breaks and incentives, price and income supports and public-funded research and development. Restrictions that can be imposed on U.S. domestic industries are seldom done to affect trade (i.e., pesticide regulations and animal welfare and control for agriculture, banning export of high technology for defense). Nonetheless, whenever the government, albeit with good intentions, imposes minimum wages, fringe benefit requirements, health and safety standards, environmental standards, etc., the cost of goods and services increases. In a global market in which competition is keen and profit margins slim, foreign producers and firms may not have the same domestic restrictions. Such policies may have the unintended consequence of shifting the comparative advantage away from a U.S. firm to the foreign firm.

Yet another type of domestic policy that affects trade is export market subsidy. The most prominent in agriculture are credit guarantees, the Export Enhancement Program (EEP) and the Market Promotion Program (MPP). These are typically provided on a case-by-case basis to enhance U.S. competitiveness, recapture lost markets, develop new markets or offset trade barriers. Credit guarantees have been offered to LDCs and to the Commonwealth of Independent States (CIS). EEP is usually offered to reduce the net cost of the product and, most often for bulk commodities, to make it more competitive with the EC or Canada when they have subsidized their sales below market prices. MPP provides assistance for potential exporters to explore and develop foreign markets. Export support programs, such as EEP and MPP will face even tougher challenges, not only because trading partners perceive them as unfair trade policy, but because some U.S. political interests see them as unnecessary, expensive and misdirected.

Domestic policies that are not directly linked to trade have come under scrutiny for their apparent adverse impact on trade. U.S. loan rates and deficiency payments for farmers in government programs have been challenged by other major exporters because they can be used to manipulate production levels and prices. The same can be said for some aspects of the EC Common Agricultural Policy.

As protection of certain commodities is removed, prices are likely to fall internally and increase the potential for growth in demand. Such price declines, when linked with possible cuts in federal price and income supports, will affect marginal producers more adversely than others. That is what efficiency means—forcing less productive resources out of their current use. Studies often support the case that net benefits to society as a whole are worth moving toward freer trade. But it may be difficult to compensate individuals and groups that lose their livelihood and are forced to relocate, retrain or remain in business but see real wealth gains wiped out.

Responses to Challenges

Regaining market share for the U.S. grain industry and expanded livestock markets will not be beneficial to all producers and agribusiness. Those who could not operate status quo without subsidies would be forced to adjust. Adjustment could take many forms: selling out, changing enterprises or enterprise mix, changing size to a larger or smaller operation, renting land rather than owning it, changing other factors of production such as fertilizer and chemical use, changing their holdings or financial portfolio, or cooperative ventures.

Domestic policies discussed to this point have been conducted at the federal level. There are also important state policies to facilitate improved situations for local producers and such policies will not be restricted by any international trade pacts. Given the probable impacts of pending trade policy and global events, they may be especially useful in the transition.

Potential state support includes: 1) management training; 2) international market development; 3) incentives for state-regulated lenders to support innovation, product and market development; 4) maintain/increase support for research and extension efforts to improve efficiency, capitalize on comparative advantage and extend these developments to trade-oriented producers and agribusiness; 5) improve efficiency of state-supported efforts both within the state and among other states through coordination and sharing of information when mutually beneficial.

Where a lack of private incentive exists, state policy can be targeted to reduce risk; encourage processing/marketing cooperatives; provide training through seminars and higher education coursework; provide short-term expertise or institutions from the state itself; identify trends and future needs. Planning based on such information could give the state's producers and agribusiness the edge in future export market share as well as in finding domestic niches or alternatives. Such activities are only the beginning of an expanded role for state assistance.

The primary challenges of the 1990s for producers and businesses in U.S. agriculture will be anticipation of sector impacts from the major geopolitical changes around the globe, accepting the dual trends to liberalize trade and provide less expensive governmental buffers for those affected, and learning to be flexible and adaptable. The land grant university has an educational role in that process that demands creativity, quality and sensitivity. Whether the land grant system has the expertise and resources to meet the challenge remains to be seen. The public has a role to recognize the importance of continuing the investment in such institutions and the necessary collective will to follow through with that support.

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