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International Agricultural Trade and Policy Center

CURRENCY VALUES AND TRADE – A STRONG U.S. DOLLAR INCREASES COMPETITION FOR U.S. PRODUCERS

By

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MISSION AND SCOPE: The International Agricultural Trade and Policy Center (IATPC) was established in 1990 in the Food and Resource Economics Department (FRED) of the Institute of Food and Agricultural Sciences (IFAS) at the University of Florida. Its mission is to provide information, education, and research directed to immediate and long-term enhancement and sustainability of international trade and natural resource use. Its scope includes not only trade and related policy issues, but also agricultural, rural, resource, environmental, food, state, national and international policies, regulations, and issues that influence trade and development.

OBJECTIVES:

The Center's objectives are to:

- Serve as a university-wide focal point and resource base for research on international agricultural trade and trade policy issues
- Facilitate dissemination of agricultural trade related research results and publications
- Encourage interaction between researchers, business and industry groups, state and federal agencies, and policymakers in the examination and discussion of agricultural trade policy questions
- Provide support to initiatives that enable a better understanding of trade and policy issues that impact the competitiveness of Florida and southeastern agriculture specialty crops and livestock in the U.S. and international markets

Currency Values and Trade – A Strong U.S. Dollar Increases Competition for U.S. Producers

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Currency values are an important factor in determining trade between countries. Most of the industrialized nations of the world moved to flexible exchange rates in the mid-1970s, allowing the exchange rate on currency between countries to be driven by relative economic values.

When you travel to a foreign country, you generally need to exchange U.S. dollars for that country's currency. For example, if you travel to Canada, you could exchange \$1 U.S. for \$1.31 Canadian (October 24 exchange rates). If inflation in the U.S. and Canada were constant and equal, and there were no barriers to trade, then a pound of beef in the U.S. would be the same price in U.S. dollars as a pound of beef in Canada in U.S. dollars, adjusted for transaction costs like transportation. In this example, if a pound of hamburger cost \$1 in the U.S., then the same pound of hamburger would cost \$1.31 Canadian in Canada. If inflation on prices is the same in the 2 countries, then this relationship will stay the same and exchange rates have no influence on trade. However, changes in exchange rates can alter the economic values on goods between countries and alter the relative values that consumers and producers realize.

Let's work with the hypothetical and assume the U.S. dollar strengthened relative to the Canadian dollar such that \$1.00 U.S. could be traded for \$1.40 Canadian. Without any change in inflation, then the price of hamburger in Canada would still be \$1.31 Canadian, but could be purchased for \$0.93 U.S. ($\$1.31 \div 1.4$). A decline in the relative value of the Canadian dollar made Canadian hamburger cheaper than U.S. prepared hamburger, until inflation adjusts the Canadian value of hamburger relative to the U.S. dollar. In this case, if U.S. buyers were importing Canadian beef, then the Canadian beef became even more attractive to the importer and made it more competitive in the U.S. market. Over the long run, inflation will make the Canadian beef price increase and eliminate the artificial advantage provided by the devaluation. In the short run, the devaluation of the Canadian dollar could injure U.S. producers of beef until Canadian inflation offsets that artificial advantage.

One of the larger devaluations to have impacted U.S. agriculture in recent years was the rapid devaluation of the Mexican peso that occurred in 1995-96. The crisis that evolved from this devaluation became known as the Tequila Crisis. The Mexican peso devaluated by more than 50 percent in a matter of just a few short months. It had significant impacts on consumers in Mexico who could no longer afford imported goods that doubled in price. It also created a market situation that favored exporting products made in Mexico instead of keeping them in Mexico to sell to their people. The resulting

impact on your market was a surge in imports of feeder cattle that depressed the market for U.S. feeder calves.

These impacts can be even more pronounced when it is the value of the U.S. dollar that changes relative to other currencies. An appreciation in the U.S. dollar relative to our major trading partners can have the same type of impact that the devaluation of the Canadian dollar had in our example. An appreciation in the value of the U.S. dollar between 1995 and 2002 has been one of the major contributors to a weak export picture for U.S. products.

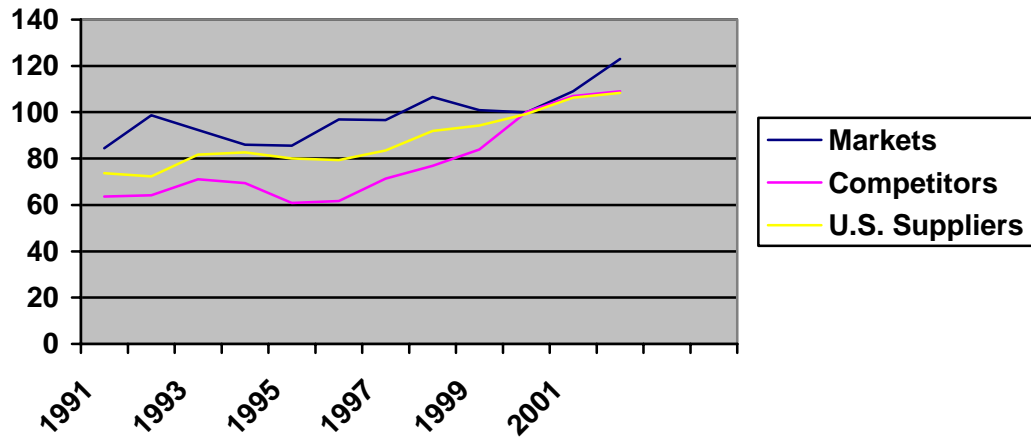
Figure 1 shows the trade weighted exchange rates for red meat products separated by trade with those countries that represent the major markets for red meat, those countries that represent the major competitors to U.S. producers of red meat products in world markets, and those countries that sell animal and products into the U.S. market. The figure shows the appreciation in the U.S. dollar between 1995 and 2002. The dollar appreciated in value in the major markets for U.S. red meats by nearly 45 percent, making it harder to sell in those markets as the price of our exports increased in their currency. The dollar appreciated nearly 80 percent relative to our competitors, making it harder to compete against other suppliers of red meat. The dollar appreciated 35 percent relative to countries exporting animals and animal products into the U.S., making it more difficult to compete in our home market. It was over this period of time that U.S. producers saw increases in imports of live animals and red meat products, and demand for U.S. products in export markets decline. Figure 2 shows the rapid rise in imports of animals and products that occurred with the appreciation in the value of the dollar. Import values increased more than 50 percent while export values for animals and products increased only 11.5 percent. The primary markets for red meat products are Northeast Asia (Japan and South Korea). The primary competitors are Australia and Europe. The primary U.S. suppliers are North America (Canada and Mexico) and Australia. The appreciation in the U.S. dollar relative to these currencies made U.S. products less competitive and helped to create more competition for our producers.

It is for these reasons that trade and policy analysts monitor exchange rates. Trade has become an integral part of the U.S. economy, particularly in agriculture. Exports account for almost 20 percent of U.S. agricultural production. The appreciation in the dollar since 1995 has had impacts across all of agriculture, making it more difficult for U.S. producers to compete in the global market. Historically, changes in the exchange rate have accounted for about 40 percent of the change in value of U.S. agricultural exports.

Trade in goods between countries is driven by the values of their respective currencies relative to the cost of producing those goods in the respective countries. The strength of the U.S. dollar is good for consumers who have access to a wider variety of more imports at cheaper prices. It is however, harder on U.S. producers who face stiffer competition when the dollar appreciates as it has since 1995. This trend has continued through 2003 and shows no sign of slowing in 2004. The USDA projects the U.S. dollar

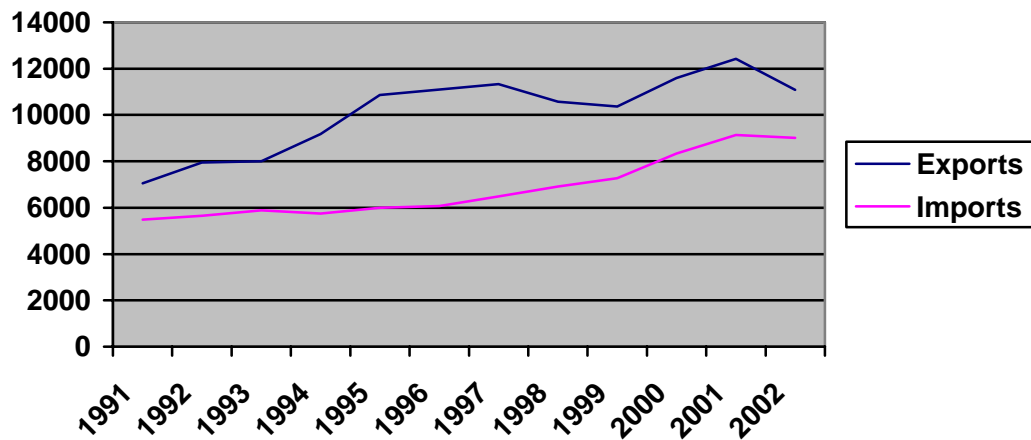
will stay strong as financial flows into the United States are attracted by well-functioning financial markets, a relatively risk-free environment, and high expected financial returns.

Figure 1. Trade weighted exchange rates for red meats in major markets for U.S producers, for major competitors to U.S. producers and for U.S. suppliers of animals and products, 1970 - 2002.



Source: USDA Economic Research Service. <http://www.ers.usda.gov/data/exchangerates/>

Figure 2. Animals and products import and export values, \$million, 1991 to 2002.



Source: USDA Economic Research Service. <http://www.ers.usda.gov/data/exchangerates/>