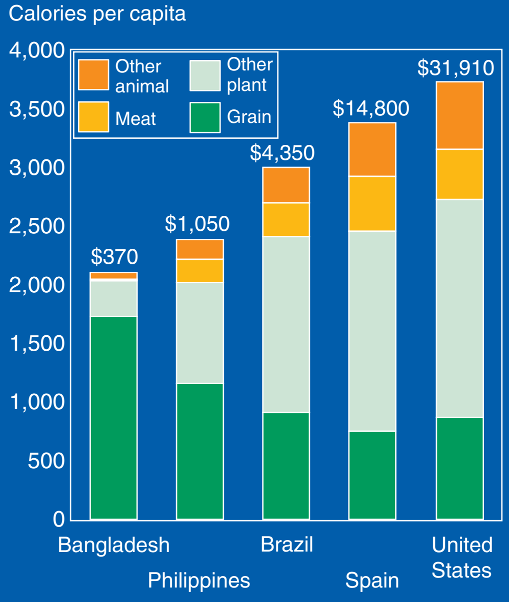
Seizing the Opportunities from Trade

To feed the world

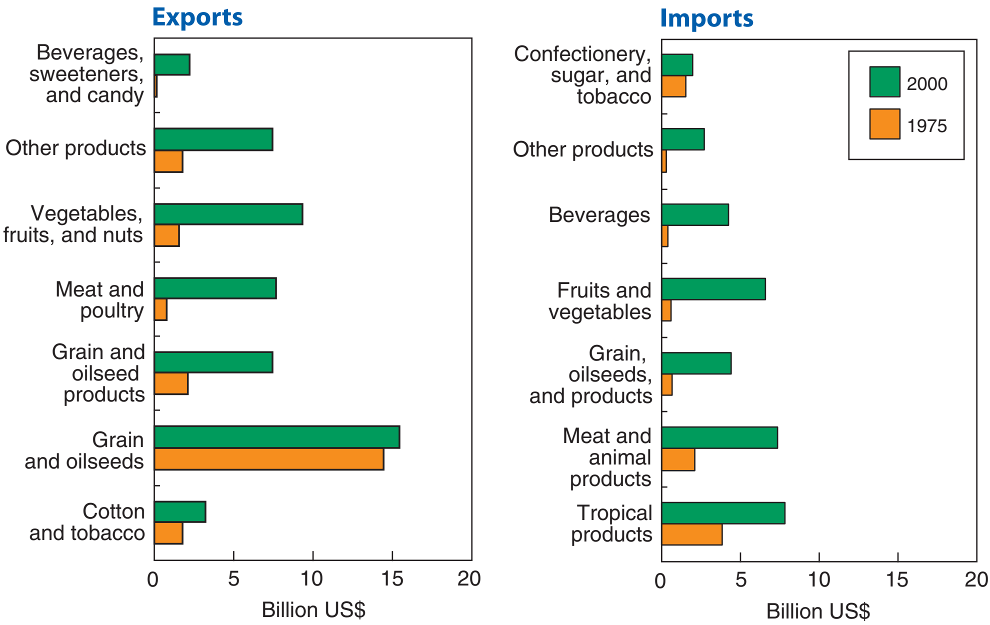
In the next 20 years, the world will gain another 1.4 billion people. Representing a 25-percent increase in global population, most of these people will live in the expanding urban centers of the developing countries and will add greatly to the world's demand for food. Prospects are good that economic growth in developing countries will continue, raising the incomes and improving the diets of the 5 billion people currently living in those countries. Demand for meats, vegetables, fruits, dairy products, vegetable oil, processed foods, beverages, and other goods will soar as consumers use greater income to diversify their diets away from grains and other staple foods. Economic growth also means increasing urbanization and, for many households, an end to growing their own food and a rise in buying food from supermarkets and convenience stores. These trends are already well underway, and urban retailers are tapping supplies from home-country producers as well as from around the world—to the extent their governments will allow.

Diets diversify as incomes rise[1]



[1]Annual per capita income.
Source: Food and Agriculture Organization, 2002.

U.S. exports and imports of high-value products have increased sharply since 1975



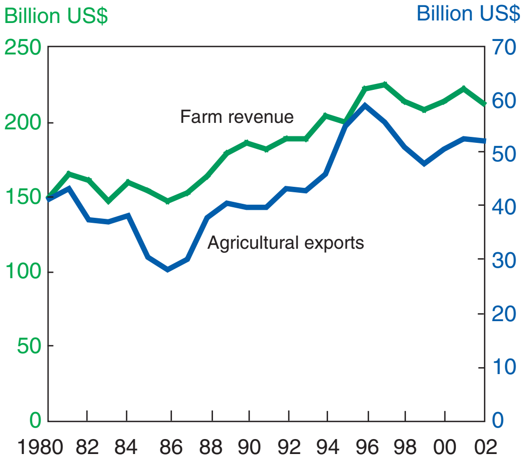
Source: Economic Research Service, USDA.

Agricultural trade is critical for U.S. agriculture

Meeting these increased food demands will be both an enormous challenge and an opportunity for the world's agricultural producers, and American farmers will play a critical role. The world's cropland, only 11 percent of total land area, is unevenly distributed. With a rich endowment of fertile land and a temperate climate, American farmers consistently produce more grains and oilseeds than the U.S. market can consume. The United States, however, is also well-equipped—with its land, technology, capital, and large-scale food processing—to provide meats, processed foods, fruits, vegetables, and vegetable oils to the rest of the world. In the last decade, 18 of the 20 fastest growing U.S. agricultural exports were high-value products, such as pork, grapes, and almonds. Trade policy reform has been very important in creating new markets, and continued export growth will depend on the degree to which markets in the developing countries are further opened to consumer-oriented, high-value products.

Agricultural exports now account for about one-fourth of cash receipts on U.S. farms. Without access to growing markets, particularly those in developing countries, the highly productive U.S. farm sector will have to accept reduced profitability and lower rates of return. And without access to U.S. products, consumers in developing countries will pay higher prices and have fewer choices. The United States itself offers an example of the benefits of importing agricultural products: The quick growth in U.S. agricultural imports in recent years has added such products as out-of-season fresh fruits and vegetables and many processed foods and beverages to consumers' choices in the marketplace.

U. S. farm revenue is tied to agricultural exports



Source: Economic Research Service, USDA.

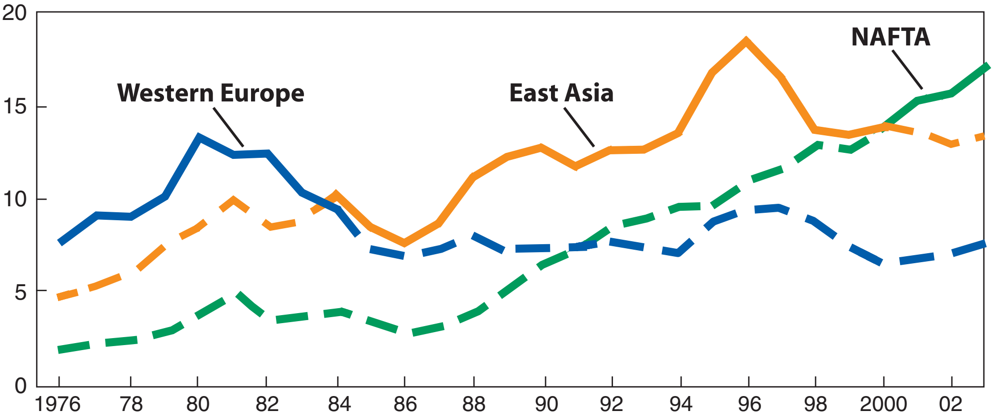
Inefficient agricultural policies, all over the globe

At present, the world agricultural trading system doesn't work as well as it could; in fact, it places a substantial extra burden on consumers and taxpayers around the world, while farmers face many constraints that sap their potential income. Many developed and developing countries keep prices of some foods high to help domestic farmers' income. This practice costs consumers money, discourages demand, and shrinks potential export markets. These policies are inefficient: Despite high consumer sacrifice, farmers get only a fraction of the extra money that consumers pay through higher prices. The Organization for Economic Cooperation and Development estimates that only 24 percent of the cost of price supports actually reaches farmers. Other policies use taxpayer funds to pay farmers to produce, which inevitably leads to bad choices—too much production of some commodities, too little of others.

Significant reform of agricultural trade would have large consequences. USDA research indicates that global gains in consumer purchasing power from agricultural trade liberalization could approach half a trillion dollars over a decade. Trade flows will increase, but the benefits to economies from removing the burden of distortionary policies are even more important. The greatest effect comes from global liberalization. Numerous trade models have shown that liberalization in agricultural markets would result in higher world market prices for most traded goods, which would benefit many farmers around the world. Consumers in markets already open to trade would also pay higher prices, but the effect on retail prices would be modest. Consumers in a number of countries that currently impose trade barriers would see lower prices, despite increases in world market prices, because the price-boosting effect of the barriers would be removed, more than offsetting global price increases.

NAFTA now the most important market for U.S. agricultural exports

U.S. exports to selected markets (billion US$)



Note: Solid line segments indicate period that the region was the most important U.S. market.
Source: Economic Research Service, USDA.

Policy reform works

Policy reform in agriculture works. It works even when countries reshape rural policies on their own, without waiting for foreign countries to liberalize their policies. Among developed countries, New Zealand's elimination of agricultural price and production support benefited its economy and improved the competitiveness of its agricultural sector. Subsequent investments by the New Zealand Government in infrastructure important to agriculture and rural communities helped farmers market their products and made off-farm employment more feasible. Among developing countries, Brazil and Chile have shown how dramatically farm output and income can rise when farmers are given shown how dramatically farm output and income can rise when farmers are given the freedom to take advantage of global markets. China's great surge in production of grain and livestock products in the 1980s and 1990s came when individual households were given the chance to determine what, when, and where to produce and sell.

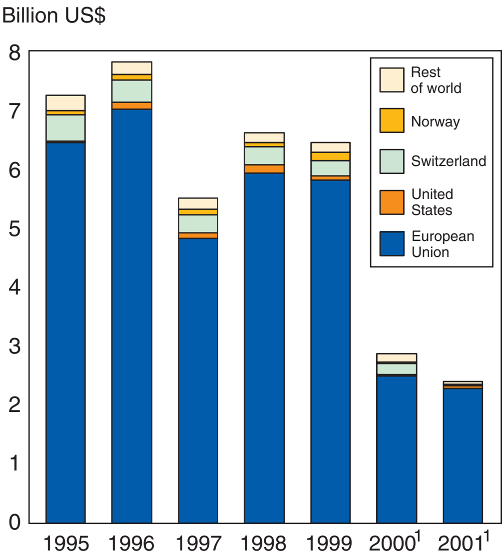
The North American Free Trade Agreement (NAFTA) is an example of the significant effects that regional trade reforms can have. NAFTA has increased U.S. agricultural exports as well as consumer choices in the United States, Mexico, and Canada. Canada is now the largest importer of U.S. agricultural products, displacing Japan in 2002. Mexico surpassed the European Union to become the third largest importer in 2000. In spite of problems in a few markets, the farm sectors in all three countries have found that integrating their markets to take advantage of differences in resources and climate can better supply consumer demand and reduce costs. Imported Canadian hogs and Mexican cattle are being fed to market weight in the United States, while American pork and beef products are sold in Mexico and Canada. Mexican grapes are filling seasonal niches in the United States, while Mexico imports more U.S. pears than any other country.

Other reforms have come through bilateral and regional agreements among countries. The United States has negotiated bilateral free trade agreements with Israel, Jordan, Chile, Singapore, and Australia, and is engaged in discussions on agreements with Bahrain and Thailand. U.S. negotiators also recently concluded a regional trade agreement with Central American countries and are pursuing agreements with other regional groupings in South Africa and the Western Hemisphere. Such agreements give U.S. farmers access to new markets and U.S. consumers access to more products.

The 1986-94 Uruguay Round of global trade reforms led to a host of changes in agricultural and trade policies, the last of which are being implemented by developing countries this year. The Uruguay Round Agreement on Agriculture (URAA) of the World Trade Organization (WTO) imposed ceilings on producer subsidies in developed countries and substantially reduced export subsidies. In response, some countries, including the United States, have changed part of their support to agriculture so that it no longer targets production of particular commodities, thereby increasing farmers' flexibility to produce what the market wants. Overall, the URAA has helped member countries reduce waste and distortions in the food and agriculture industries caused by earlier policies.

Experience has shown that policy reform in agriculture can produce benefits for the economy, even when it is done by one country alone. Potential benefits for the economy and agriculture, however, are greater when bilateral and regional agreements shape policy reform because many new opportunities for trade are opened. The biggest reward for the United States comes when policy reform is global, for then, the American economy and agriculture will be able to reap the greatest opportunities in the global marketplace.

The URAA has led to reductions in export subsidies

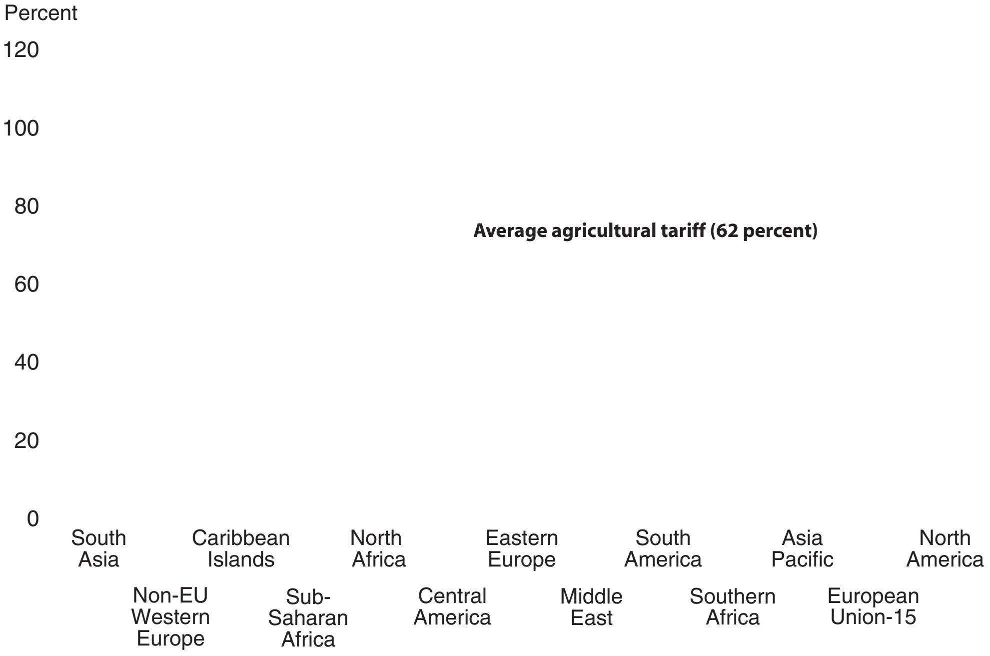


[1]Not all countries have notified the World Trade Organization (WTO) as yet for this year.
Source: Economic Research Service, USDA, calculations from WTO export subsidy notifications.

Reform can't wait

A great achievement of the URAA was to cap tariffs and other supports and to make them more transparent. Thus, the whole world can now see more clearly how large the burden is on world agricultural trade, on food consumers in most countries, and on taxpayers in many countries. Farmers in developed and developing countries can see how high the remaining barriers to their exports are, and how uneven and unfair the world's agricultural marketplaces can be. For example, globally, agri-food tariffs average 62 percent, in contrast to U.S. tariffs on agricultural products, which average only 12 percent. Clearing away the remaining inefficient and costly agricultural policies should be the order of the day.

Inequities in tariffs remain[1]



[1] Tariffs are bound most-favored-nation rates based on final URAA implementation.
Source: Economic Research Service, USDA.

A big obstacle to further reform is the reality that some people's livelihood can be hurt by trade liberalization and agricultural policy reform. Any losses they face, however, are outweighed by the gains that most people would see from reforms. Strengthening the economic infrastructure and vital services of the rural sector and providing adjustment assistance to those who lose income from reforms should be possible in the developed countries.

In developing countries, the reform process itself could be adjusted in multilateral negotiations. Farmers who have few alternatives and are not ready for global competition could be afforded longer adjustment periods. Since prices for most agricultural commodities are expected to rise in the wake of reform, benefiting farmers worldwide, consumers of staple foods in relatively poor countries that don't currently have import barriers could also be hurt. Decisions about adjustment assistance and flexibility in meeting policy reform objectives should be informed by past experiences with support for agriculture. Instead of propping up farm prices or encouraging greater production of specific products, subsidies are better spent on education, health care, and rural infrastructure, or as direct grants to rural households.

The whole economy, and U.S. agriculture, will benefit by moving decisively, now, to continue to open up global markets for agricultural products. Failure to further reform global trade policies and domestic agricultural policies will make much of the foreseeable demand growth in the next decades off limits to U.S. suppliers. In addition, agricultural product prices facing U.S. farmers will be lower than they otherwise would be. Another consequence of failing to reform trade policies is that U.S. consumers and food processors would continue to face high tariffs on certain imports. Failing to push reforms forward raises further risks. Developed countries could backslide, relying more on protectionist policies. Developing countries could also make greater use of misguided policies as their growing wealth allows them to make the wrong choices: higher tariffs and commodity subsidies.

Under current global trade rules, government policies often misdirect agricultural resources toward the production patterns of the past. Such policies are ill suited to satisfying evolving consumer demand in global food markets. In contrast, global agricultural policy reform offers economic gains that billions of people could share. The United States and the world should seize the opportunity presented by the current round of global trade negotiations, the Doha Development Agenda, and press for the greatest possible reform.

February 2004

USDA