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STUDY BY THE STAFF OF THE U S

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General Accounting Office

Agricultural Trade: Issues Affecting U.S. Agricultural Policy

Agricultural trade is one of the few bright spots in U S trade, providing a positive balance of payments of over \$14 billion in 1978. However, while our exports provide billions of dollars to the U S economy they also may help subsidize the agricultural system of some developed countries and may actually hinder agricultural development in some developing nations. Food imports may threaten the viability of certain types of U S farmers while contributing to income inequities in the exporting country. This staff study uses U S agricultural trade with Mexico as an example of how some of these issues are manifested.



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FOREWORD

Agricultural trade contributes over \$14 billion yearly toward the U.S. balance of payments--second only to capital goods in this respect. Not only does the United States feed the 225 million persons in this country, but it contributes significantly toward feeding millions of others the world over. No other country has such a beneficial mixture of climate, technology, manpower, capital, and land that can provide this amount of food.

This staff study briefly examines the issues arising from our increased agricultural trade and focuses on the unexpected effects such trade might have on the well-being of U.S. farmers as well as on the agricultural structure of our trading partners.

U.S. food exports pour billions of dollars (\$29.4 billion in 1978) into the U.S. economy. However, these exports, sold at a relatively inexpensive price, may also help subsidize the agricultural system of some developed countries and may actually hinder agricultural development in some developing nations. The United States also imports about \$14.8 billion of agricultural products yearly. Food imports offer the domestic consumer a greater seasonal variety of foods at competitive or lower prices; they may also threaten the viability of certain U.S. farmers while contributing to income inequities within the exporting country. This study uses U.S. agricultural trade with Mexico as an example of how some of these issues are manifested.

Any change to our agriculture policy should be analyzed carefully to determine not only its probable effect on domestic food prices and farm income but also on the changes in structure of the American farm and on the impact to our trading partners' agricultural systems. This study discusses these matters and notes several issues that should be addressed by the Congress and the administration in establishing U.S. agriculture policy.

Any questions or opinions on the issues in this study should be addressed to William Gahr, Food Coordination and Analysis Staff, (202) 275-5525.



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C o n t e n t s

		<u>Page</u>
FOREWORD		
CHAPTER		
1	INTRODUCTION	1
2	AGRICULTURAL EXPORTS	2
	Issues for discussion	4
3	AGRICULTURAL IMPORTS	7
	Issues for discussion	8
4	U.S. TRADE WITH MEXICO	9
	U.S. involvement in Mexican agriculture	10
	Low wages provide a competitive edge	11
	U.S. Mexican trade negotiations	11
	What would be the impact on the United States?	12
	Issues for discussion	12

ABBREVIATIONS

GAO	General Accounting Office
USDA	Department of Agriculture

CHAPTER 1

INTRODUCTION

Agricultural trade has always been viewed as largely beneficial to both our economy and to those nations with which we trade. Such trade boosts the U.S. balance of payments and provides income for U.S. farmers while offering other nations a comparatively inexpensive and reliable source of food. The U.S. agricultural system contributes significantly toward feeding the world's population. Although some signs indicate that this system may be losing some of its resiliency, 1/ no other country has the favorable conditions that enable the United States to produce food not only for the 225 million inhabitants of this country, but for millions elsewhere as well.

While agricultural trade does benefit our economy, some aspects of this trade may prove to be counterproductive to the continued well-being of American farmers and may have unexpected effects upon the agricultural structure of our trading partners. This paper will briefly examine the possible impact that agricultural trade has on the domestic farm sector as well as the incidental impact on other nations.

The material presented in this report was gathered from interviews with officials from the State Department and Department of Agriculture (USDA) and from discussions with others knowledgeable about agricultural trade. Much of this information--particularly the section on U.S. trade with Mexico--was gathered by a GAO consultant.

The issues covered in this paper are not inclusive and clearly warrant further study and discussion. Our purpose is to identify issues and increase awareness of the impact agricultural trade has on the agricultural structure of both the United States and other nations.

1/For a detailed explanation of the domestic factors leading to a loss of resiliency in U.S. agriculture, refer to the GAO report: "Changing Character and Structure of American Agriculture: An Overview," CED-78-178, Sept. 26, 1978.

CHAPTER 2

AGRICULTURAL EXPORTS

In 1978, the United States had a trade deficit of \$34.2 billion with large deficits in fuels, consumer goods, and automobiles. Agriculture provided a significant surplus--\$14.6 billion, second only to the trade surplus of capital goods--that helped keep the deficit from being even higher.

Additionally, the United States provides agricultural products through bilateral or multilateral trade agreements with other nations. Food assistance can be critically important in assisting other nations to develop their own agricultural system and to alleviate hunger. However, food assistance is less important (because of the relatively small volume) in affecting our own agricultural system, except in those cases where concessional sales ^{1/} lead to future sales of agricultural commodities and other goods. Food assistance can be important to the United States in other ways. It can lead to long-term political stability in some regions of the world, increase our prestige and image, and enhance our diplomatic position in countries believed critical for strategic purposes.

Under our present pricing and production system, agricultural exports are necessary to the U.S. farm economy. The U.S. agricultural system is capable of producing far more than can be domestically consumed. We currently export about 75 percent of our rice, more than 70 percent of our wheat, 50 percent of our soybeans, and 25 percent of our corn. Over 1 million farm and nonfarm jobs are directly or indirectly linked to producing, assembling, and distributing farm exports.

Food exports also generate new business activity and in doing so, effectively create "new" money that would not otherwise exist. This concept is called a "multiplier effect" and is generally assumed to be 1 for U.S. food exports. Thus, exports of \$29.4 billion--the agricultural export figure for 1978--generate another \$29 billion in new business activity.

^{1/}Sales made with favorable repayment terms such as reduced interest.

Most of the dollar value of U.S. food exports is in grain sales which clearly dominate the world grain market. The United States and Canada control about two-thirds of the world grain trade, with the United States having most of this. The U.S. price effectively is the world price, which is considered by purchasers to be relatively low. Because of a shortfall in world supplies this year, U.S. grain prices have risen considerably above last year's level.

The continued abundance and relatively low price of U.S. grain has created a situation in which (1) American farmers must rely on export sales for income, assuming the current price and margin on grain sales, (2) some developed nations use cheap U.S. grain to help subsidize their own farm economy, and (3) some developing countries choose to use grain imports rather than establish their own production facilities.

The variables in foreign demand are a major cause of fluctuations in U.S. grain prices. In years of subnormal demand, prices would tend to fall and the Commodity Credit Corporation would likely have to assume ownership of much of the surplus grain. In high-demand years, supplies are tightened and prices rise, often considerably. Thus, both the farmer and the consumer are subject to price buffeting as world demand varies. Since foreign demand consists of so many variables, controlled not only by climate and energy availability but by the regulations and economic policies of dozens of countries, predicting foreign demand accurately is difficult. Low grain prices effectively assure farmers of a market for their high-volume grain production. At the present margin, the U.S. farmer needs the foreign market to survive.

It has been suggested that some nations may take advantage of low U.S. grain prices to support their own agricultural industry. Most developed countries impose tariffs or some other form of tax to raise the price level of grain entering their country. By taxing food imports, these nations can better afford to subsidize crops grown by their own farmers. In effect, low U.S./world prices provide an income support mechanism for foreign agriculture.

Similarly, other nations may import inexpensive grain rather than develop their own internal food resources. For these nations, it is a question of how to allocate scarce resources, and in many instances it may simply be less expensive to purchase grain rather than grow it. However, these countries may find buying grain to be counterproductive if they ever decide to begin producing it domestically. If prices escalate sharply or a shortfall occurs, producing

grain to meet even the most basic levels of subsistence might prove difficult without the long leadtime necessary to develop a domestic agricultural system.

ISSUES FOR DISCUSSION

It appears that, for the most part, U.S. exports--under present conditions--benefit both our Nation's economy and those with which we trade. The United States has a surplus product which it sells to willing customers. However, as noted above, U.S. export trade can and likely does have a much broader effect than simply disposing of surplus grain. Although it seems to be generally accepted that the United States should sell as much as possible, very little analysis has been made on whether our trade can create inequitable economic and social situations for both our Nation and our trading partners. The following questions need to be explored.

1. Is it in the best interest of American agriculture to produce as much as it does for export?
2. Is it reasonable for U.S. grain price levels to act as a support mechanism for agricultural systems in other countries?
3. Is the United States ultimately shortchanging those developing countries that depend upon U.S. food-stuffs by selling to them so cheaply that their own agricultural resources are not developed?
4. What impact does the U.S. agricultural system have on resource distribution in the developing countries?
5. Should the United States use its vast export resources as leverage to improve its own economic outlook?

Central to all of these questions is the economic condition of the U.S. farmer. Without a viable farm system, options for improving our export trade are limited. To quote from our September 1978 report,

"* * * a series of cost-price squeezes, specialized technology, and the targeting of Government farm programs have created a farm sector that has fewer, larger, and more powerful farms; less family labor; less diverse production patterns; and increasing dependence on purchased inputs, foreign oil, and markets outside the United States. Farm numbers

have dropped from a high of 6.8 million in 1935 to 2.34 million in 1974. Even though the average farm has grown in size, over half of all farmers receive income from off-farm sources. The average farm family took in nearly 60 percent of its total income from other sources."

There are no easy solutions to the American farmer's problems. Two major farm organizations have proposed that farm prices be restored to a parity level. 1/ To achieve parity, prices for farm commodities would need to be increased about 50 percent (of 1978 prices) on the average. In addition to causing an immediate jump in consumer price levels, such an action could considerably alter our export position. For example:

- According to USDA, the dollar volume of exports would rise although physical volume would decline as demand slackened with the price increase.
- Cost increases could constrain some developing nations from expanding their market for U.S. food-stuffs and in some cases could reduce their purchases. 2/
- Without food assistance, some developing nations could be faced with short-term or even long-term food shortages. However, since basic grains are primarily raised by the rural poor in these countries, increased demand would likely raise income levels for the rural poor.
- Developed nations may not be as affected by price increases since the world price would still be less than their internally set domestic price. Their import tax could be adjusted so that domestic price would not be affected. Fewer instances would occur where U.S. grain imports would act as an income support mechanism for farmers in that country.

1/Parity is a measure of price relationships. In this instance, parity refers to the ratio of prices received by farmers to prices paid by farmers. This ratio is indexed to a base year.

2/This possible outcome conflicts to some degree with a recent speech by a high-level USDA official, who indicated that developing nations were not strongly influenced by price.

--A sharp U.S. price increase would invite more serious foreign competition for grain sales, particularly for those countries which need to improve their production plant or transportation facilities but have been hampered in doing so by low U.S. grain prices. Assuming normal world production, USDA projects declining exports over a 5-year period following adoption of a parity price, unless a grain cartel could be established among the major grain exporting nations--something USDA does not think can be done.

--Higher priced exports could lead to a decreased sales volume and could mean a production shift for U.S. farmers. A decrease in American farm production could lead to less flexibility in meeting domestic food needs because of some farm land being diverted for non-agricultural development or permanent grass cover (possibly leading to more production of grass-fed beef).

Another possibility of altering the U.S. food export structure without disrupting domestic prices would be to sell grain through a market or trade board which would establish a price and accept orders or allow grain trading companies to process orders through the board. Such a structure could allow the establishment of a two-tiered pricing system--one for domestic consumption and another for foreign sales. Such a system would still need to rely upon a trading cartel to be fully effective.

CHAPTER 3

AGRICULTURAL IMPORTS

The United States imports about \$14.8 billion in foodstuffs each year. About 47 percent is complementary goods; that is, food which cannot be grown domestically in sufficient quantities to satisfy domestic demand. Such foods include coffee; bananas; and certain other fruits, nuts, and vegetables. Food items such as tomatoes, which are grown domestically as well as imported in substantial quantities, are called supplementary imports.

As is the case with food exports, a multiplier effect is associated with food imports. USDA has estimated that the multiplier for supplementary imports is 2-1/2 because on the average most of these types of food imports require more handling, storage, processing, etc. than do our export foods. What this means is that for each \$1 of supplementary food products that the United States imports, an additional \$1.50 would have been generated if it had produced and processed those products domestically. This meant a loss to the U.S. economy of about \$19.5 billion in 1978.

Supplementary food imports compete with U.S. products because they are often less expensive, have seasonal availability, geographic advantages, or are dumped on the U.S. market. Several effects on the U.S. farm sector and on U.S. consumers result:

- U.S. consumers may get a price break on food because of the availability of imports.
- Consumers sometimes have more access to particular commodities because of seasonal availability or geographic location.
- U.S. farm products sometimes must sell at or below production costs to compete with foreign imports.
- In some cases, heavy volume of agricultural imports could severely damage U.S. agriculture to the point where some farmers go out of business. In that case, some production viability is lost (if there are no other viable agricultural alternatives available), in that cropland may be switched to other uses and may not be available if imports are curtailed or if prices of those imports increase. If such a situation developed, the United States could become largely or completely dependent on certain foreign foodstuffs which were once grown domestically.

--The United States has less control over the quality and safety of food produced in other countries.

ISSUES FOR DISCUSSION

Food imports--especially those that compete with domestic products--can endanger the economic viability of some U.S. farmers. There is clearly a trade-off between the continued viability of these farmers and a broader choice of food at lower prices for domestic consumers. Questions also exist concerning trade agreements and freedom of entry to other countries. Other questions vary from product to product and from country to country. Without knowing the extent of the food import problem and without having a specific goal or objective for the continued viability of affected farm producers, the United States cannot address these issues adequately.

CHAPTER 4

U.S. TRADE WITH MEXICO

We chose to examine Mexico as a specific example of how food trade can influence the structure of our agricultural system as well as that of another nation. Mexico was selected because of the economic and cultural ties between it and the United States and because of Mexican immigration into the United States and the emerging Mexican oil industry, both of which have been linked to food trade and agricultural development within Mexico.

Mexico shares with many other developing countries the problem of inequitable income distribution. The top 10 percent of income earners receive 40 percent of total income and the bottom 40 percent receive only 10 percent of the total income.

As in other countries having inequitable income distribution, Mexico's nutritional status reflects its economic imbalance. Several estimates, including studies by the World Bank, place the number of chronically malnourished in Mexico at 30 percent or more of the population. Mexican infant mortality is more than 60 deaths per 1,000 births as compared with 15 per 1,000 in the United States. A Mexican Government report stated that 100,000 children die yearly of infections which could be prevented through proper nutrition.

Mexico's nutritional status and its income distribution are largely manifestations of its agricultural development policies. Land reform was instituted after the end of the Mexican revolution in 1917 but was not seriously implemented until the administration of President Cardenas in 1934. Cardenas greatly expanded the ejido system, in which land was granted to a community for collective farming or for redistribution into individual plots. By 1940, Cardenas had increased ejido holdings from 800,000 to 3.5 million hectares. Under subsequent administrations, this trend was reversed, and much of the newly available land was going to businessmen and others who often controlled land in excess of the legal limit of 100 hectares.

Mexican farmers are further hampered by their lack of credit. The World Bank reports that 75 percent of Mexico's small farms have no access to credit. The "green revolution" which led to the development of high-yielding seed varieties favored the large farmer who had irrigated farmland. Only 4.5 percent of Mexico's farmers control 35 percent of this farmland. One must consider that 50 percent of Mexico's total crop production depends upon irrigation and 60 percent

of the total public agricultural investment had been devoted to irrigation.

Trade with the United States reinforces these patterns, as this type of cropland is largely used to grow fruit and vegetables--much of which is exported to the United States.

U.S. INVOLVEMENT IN MEXICAN AGRICULTURE

U.S. business firms are heavily involved in Mexican agriculture. The Mexican constitution prohibits foreign interests from owning land, and fear of expropriation is said to limit loans; but according to one trade directory, at least 65 U.S. food-related firms have a substantial direct investment--either as sole owner or partner in Mexican companies or by financing production through loans. In 1978, the United States purchased \$1.1 billion in agricultural products from Mexico. In return, Mexico has become dependent on the United States for corn, and to a lesser degree, for grain sorghum and soybeans.

Agricultural specialists in the United States and Mexico report that Mexico hopes to increase its food exports to the United States. A State Department official said the possibility exists that within 10 to 20 years Mexico could supply all of the fruit and vegetables consumed in the United States during the winter months. Currently, Mexico provides about 50 percent of the tomatoes consumed (\$161 million in 1978) in the United States during the winter and lesser quantities of other vegetables. Produce exports in which Mexico has already developed or is likely to develop a significant U.S. market include, in addition to tomatoes: squash, eggplants, cucumbers, bell peppers, beans, asparagus, okra, broccoli, cauliflower, brussels sprouts, onions, strawberries, limes, mangoes, and avacados.

One aspect of Mexico's export plans is reportedly the development of a large agricultural district in Baja California which would give Mexico the capacity to grow produce the year round. This production could place Mexico in more direct competition with U.S. producers, particularly in California.

In June 1978, the World Bank gave Mexico a \$200 million agricultural loan which is to be part of a \$627 million agricultural investment package, 18 percent of which is reportedly intended for Baja California, Sonora, and Sinaloa.

A Mexican economist said that the degree to which export production is developed will depend largely on the degree of

U.S. investment. A larger investment issue, however, is the amount of access the United States will give to Mexican food exports.

LOW WAGES PROVIDE A COMPETITIVE EDGE

Mexico's competitive advantage in agriculture results largely from the relatively low wages paid to agricultural workers. One study found that agricultural workers in west central Mexico were being paid about \$1.35 a day compared to \$2.50 an hour for similar work in the United States. Another study indicated that wages are kept low because there is an overabundance of labor and because wages are the only factor Mexican growers can manipulate to compete with U.S. growers. Other costs for chemicals, machinery, and seed are largely inflexible.

U.S.-MEXICAN TRADE NEGOTIATIONS

In its current trade negotiations with the United States, Mexico is seeking reduced tariffs for its produce and guaranteed access to the U.S. market. Mexico has been concerned by the variable implementation of marketing orders and proposed legislation aimed at protecting U.S. growers. Mexico would also like to develop a larger U.S. market for canned and frozen produce and for meat.

The United States is proposing that if these concessions are to be granted, Mexico must allow greater access to U.S. corn, sorghum, and soybeans as well as certain other foods, including pears and peaches. U.S. grain would be used in part to feed cattle for export to the United States. Mexico currently licenses imports of corn, sorghum, and soybeans but wants to limit access in order to maintain incentives for Mexican production. Mexico's official policy aims to return to self-sufficiency in grain production; but given its emphasis on producing fruit and vegetables for export, Mexico may increase its dependency on U.S. grain.

Consequently, Mexico could become a larger supplier of U.S. produce and meat, while the United States would supply Mexico with larger quantities of grain. However, this situation could change if the Mexican Government adopted a more rigorous self-sufficiency policy, thereby reducing emphasis on food for export, at least temporarily.

WHAT WOULD BE THE IMPACT ON THE UNITED STATES?

The long-term impact on U.S. farmers and consumers of increasing U.S. dependence on Mexican agriculture is not clear, and interviews with U.S. officials indicate this issue has not been studied. In the short term, increased imports of winter vegetables from Mexico could severely reduce or eliminate Florida's winter vegetable production and possibly affect other States. If Florida croplands were taken out of production, it is unlikely that they could be recovered because of competing use for the land. Already this year Florida tomato producers have charged Mexican producers with illegally dumping tomatoes into the U.S. market. Before the Treasury Department could rule on the matter, Florida growers withdrew their petition under the assurance that the United States and Mexico would begin negotiations on imported Mexican produce. (Fig. 1 shows the relationship of Mexican tomato production to that of major tomato-producing States.)

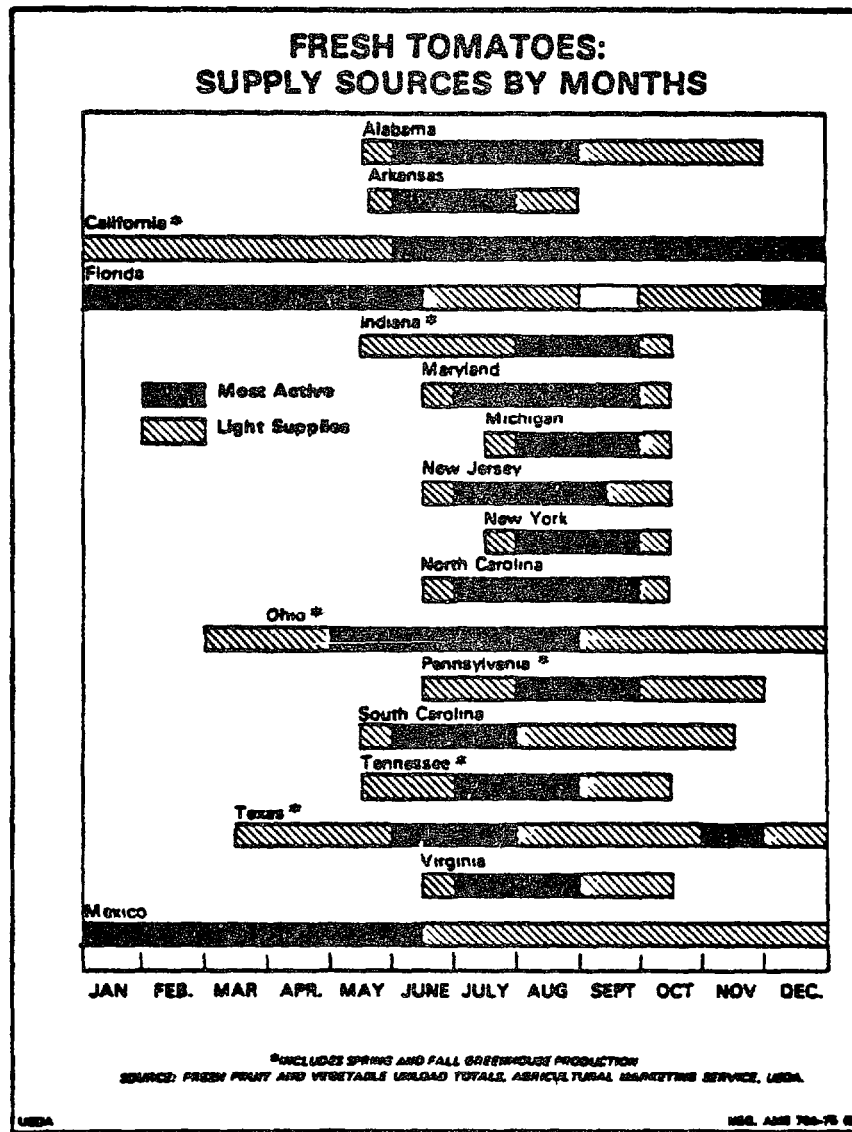
The effects outside of key produce-growing States are less clear. During the period of increased Mexican imports of winter vegetables, tomato production declined in six States, remained the same in four, and increased in one. During this period, USDA reported that tomato production became more concentrated in Florida and California. Whether this trend is directly related to the Mexican imports is not certain, but there has been greater concentration of production and, consequently, a greater concentration in control of marketing. Factors affecting this concentration have included weather; increased irrigation in warm climates; mechanization, and possibly the migration of Mexican farm workers into growing areas, particularly in the Southwest.

A further shift of produce production into Mexico could further concentrate control of produce marketing in the United States. For example, U.S. supermarket chains have brokerage houses in Nogales, Arizona, the distribution center for much of the produce coming from Mexico. As more produce comes from Mexico, it may be that these chains will market an increasing amount of fruit and vegetables consumed in the United States.

ISSUES FOR DISCUSSION

U.S. agricultural plans are interrelated with a variety of other interests; for example, grain sales have provided income with which the United States has purchased oil. The fruit and vegetable and grain trade between Mexico and the United States is related to U.S.-Mexican oil negotiations.

FIGURE 1



The development of trading patterns such as those just discussed, however, raises a fundamental question about the course of U.S. agriculture in terms of the domestic farm structure: Should production of various foods be further concentrated in specific geographical areas, including areas outside the country, or should various regions in the United States develop greater self-sufficiency in a variety of staple crops? This question is basic to the structure of the rest of the food system, since the location of crop production determines the structure of food marketing. For example, food grown close to metropolitan areas may be marketed directly in cities by farmers or farmer cooperatives rather than through international distribution networks. This question also addresses the issue of what size farm will be viable, since concentration of production of specialized crops favors larger farm organization.

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