

U.S. Agricultural Policy and Rural Growth in the Context of Globalization

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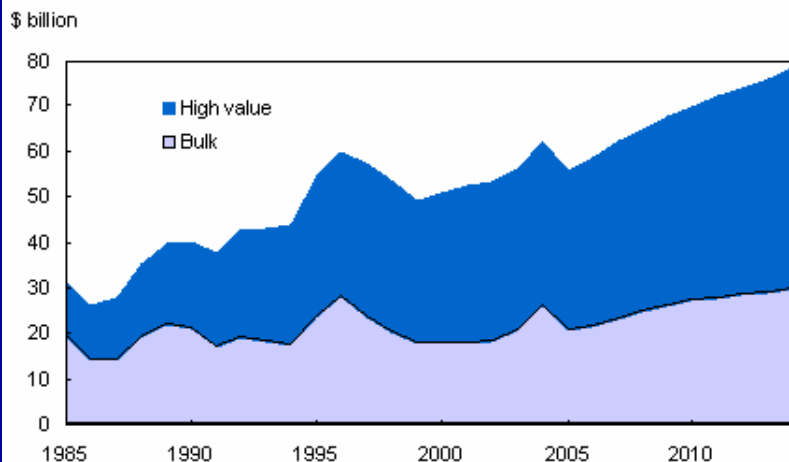
Outline of Presentation

- Where the export market growth potential is and where the competition is likely to be
- Policies needed to ensure competitiveness of U.S. agriculture
- Does U.S. farm policy help or hurt?
- Importance of international trade negotiations
- Need to proceed with agricultural policy reform regardless of what happens in the Doha Round

Exports Are Key to Midwest Agricultural Profitability

- American agriculture exports $\frac{1}{4}$ to $\frac{1}{3}$ of its production of many commodities.
- Exports can grow by expanding the total size of the market or by increasing market share.
- The only large potential growth market is in presently low income countries
- The outcome of the WTO trade negotiations will determine how much of this “potential” is realized

U.S. agricultural export value: Bulk and high value 1/



1/ Bulk commodities include wheat, rice, feed grains, soybeans, cotton, and tobacco. High-value products include semi-processed and processed grains and oilseeds, animals and animal products, horticultural products, and sugar and tropical products.

Source: *USDA Agricultural Baseline Projections to 2014*, February 2005.
Economic Research Service, USDA.

Globalization

- Increasing integration of economies (from the most local level) around the world
 - Trade
 - Technology/knowledge
 - People/labor
 - Financial capital
- Result of technological advances that reduce cost and increase speed of international transactions
- Creates unprecedented opportunities for specialization and exchange of goods and services (global sourcing & supply chains)
- Exposes previously isolated markets to competition

Agricultural Competitiveness

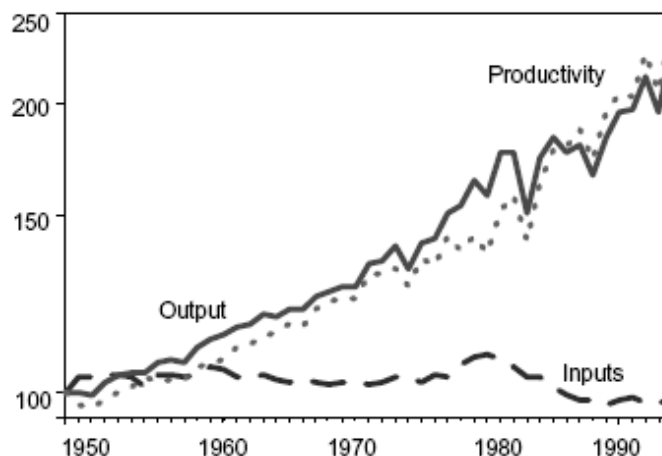
- *Commodities* – by definition undifferentiated products, so low cost supplier gets the sale
 - Research essential to minimize unit cost of production; also need low transport and regulatory costs.
- *Differentiated products* – Quality, innovation, design and uniqueness in the eye of the consumer create opportunities to get a higher price than could be obtained for a commodity
 - Research essential to new product development and quality improvement, as well as identification of potential markets

U.S. Ag Productivity Growth Success Story

- In 2002, U.S. farm output was 2.6 times what it was in 1948.
- It was produced with fewer total inputs than were used in 1948!
- This was a much higher productivity growth rate than in the rest of the U.S. economy!
- The estimated annual real rate of return on public investments in agricultural research is in the range of 30-60 percent – one of the highest payoff investments in the American economy!

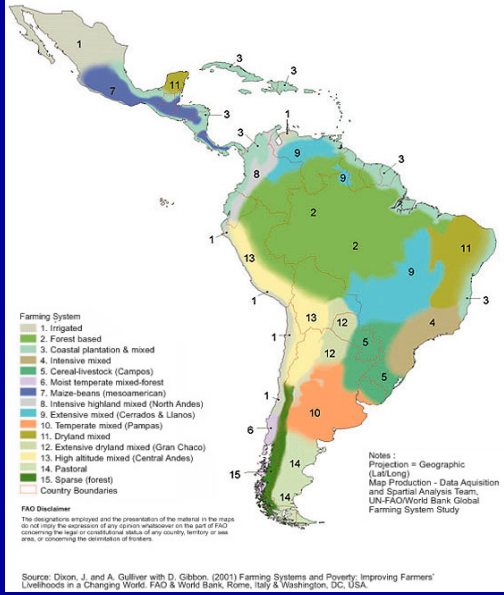
Productivity is the driving force behind changes in agricultural output.

1948 = 100 (Log Scale)

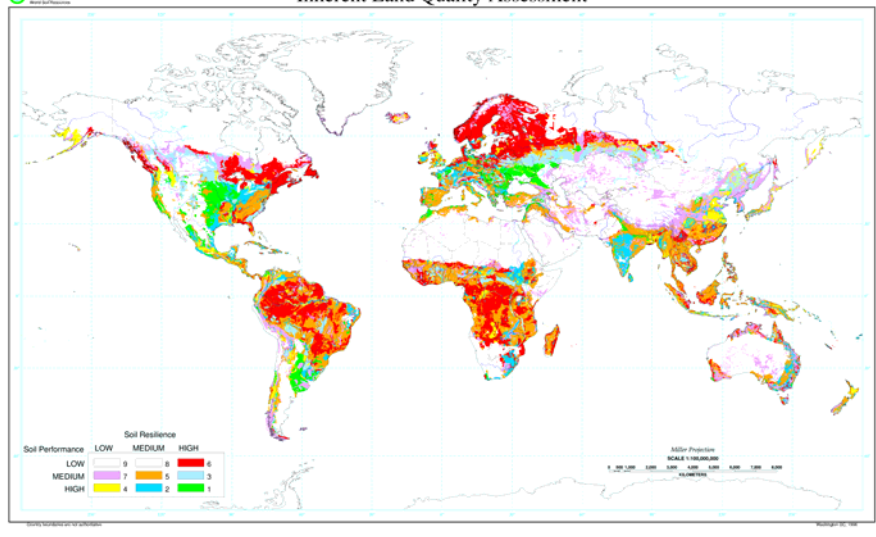


Source: Economic Research Service, U.S. Department of Agriculture.

Major Farming Systems Latin America & Caribbean Map 1



Inherent Land Quality Assessment



Larger Fraction of World Food Production to Move Through Trade

- The world's arable land and fresh water are not distributed around in the world in the same proportions as is population.
 - No way for Asia or Middle East to be self-sufficient in food
- With population growth, urbanization and broad-based economic development, many LDCs' food consumption to outstrip their production capacity and they will become larger net importers.
- Efficient producers of feed grains and soybeans, wherever they are, will benefit significantly.

Projected Population Growth

(U.N. medium projections)

• <u>Region</u>	<u>2005</u>	<u>2050</u>	
• World	6,465	9,076	+ 40%
• High Income	1,211	1,236	+ 2%
• Low Income	5,253	7,840	+ 49%
• Africa	906	1,937	+114%
• Asia	3,905	5,217	+ 33%
• Latin America	561	783	+ 40%
• North America	331	438	+ 32%
• Europe	728	653	- 10%

More than Half of the World's Population Lives on <\$2/day

Sub-Saharan Africa	75%
South-Central Asia	75%
China	47%
North Africa	29%
Latin America & Caribbean	26%
Eastern Europe	14%
The World	53%

Source: World Bank [World Development Indicators 2005](#)

Projected World Food Demand

- World food demand could double by 2050
 - 50% increase from world population growth – all in developing countries
 - 50% increase possible if low income countries achieve broad-based economic growth
- How many presently low income consumers are lifted out of poverty will be the *most important* determinant of the future size of world food and agricultural product markets.
- The ability of low income countries to export the products in which they have a comparative advantage will constrain their ability to reduce poverty.

Policies Needed To Realize Potential Market Growth in Developing Countries

- A more open trading environment that can stimulate faster economic growth
- Market access for goods in which developing countries have a comparative advantage
- Eliminate import barriers and domestic and export subsidies which depress world market prices and increase their variance
- Foreign aid and international lending for investment in necessary infrastructure, technology, know-how, etc. and to facilitate adjustment.

Playing Field Is Far from Level

- Most high income countries subsidize their agriculture, distorting relative returns to various outputs and inducing larger total investment in agriculture relative to other sectors.
- Many LDCs' food policies turn the terms of trade against agriculture to keep urban food prices low, reducing the incentive to invest; agriculture underperforms relative to its potential.
- Protectionist import policies and export subsidies further distort what is produced where.

U.S. Producer Support, 2001-2003 (Percent of gross farm receipts)

Sugar	58
Milk	44
Rice	44
Sorghum	37
Wheat	34
Barley	30
Corn	20
Soybean	19
Wool and lamb	17
Pork, beef and broilers	4
Overall	19

Source: OECD PSE database

Domestic Effects of Protection and Subsidies to Agriculture

- Increase total investment in agricultural sector relative to other sectors of the economy
- Distortions in relative prices distort what gets produced where.
- Inflate price of land and other fixed assets
 - Largest producers and farm land owners get most of the benefits
- Retain too many people in agriculture
 - Out-migration is normal and essential.
 - Effects of trade liberalization are often confused with adjustment that occurs normally during economic development.

External Effects of Ag Protection and Subsidies

- In net importers, smaller imports result in lower world price than would otherwise be the case, e.g. US sugar & dairy and Japan rice
- In net exporters, larger production and exports depress world market price below where it would otherwise be, e.g. US cotton and EU sugar
- Notes:
 - Important to distinguish between long-term downward trend in world price and effects of subsidies
 - Non-tariff barriers to imports may reduce domestic price variability while increasing volatility of world market prices received by other countries' farmers.

Recognition that Farm Programs Aren't Achieving Stated Objectives

- Low farm family income
 - Most payments go to larger producers whose family incomes & wealth are well above average
 - Low income farmers receive very little from programs
- Variability of farm income
 - Farmers have income averaging and cash accounting
- Increase competitiveness
 - Capitalization of payments into land values raises U.S. cost of production and undercuts international competitiveness
 - Public investments in ag research declining
- Food security
 - Not a credible problem when U.S. ag grows 1/3 more than we use domestically
- Rural development
 - Payments facilitate consolidation; don't create more jobs

American Leadership Was Key in Uruguay Round Ag Negotiations, but the 2002 Farm Bill Hurt Our Credibility Abroad

- While telling the rest of the world to cut farm subsidies, we increased budget authority for ours.
- Retreated on decoupling: By allowing bases to be updated, U.S. farmers know that “fixed payments” are not necessarily “fixed.”
- Counter-cyclical payments will reduce U.S. farmers’ responsiveness to (downside) market signals.
- Marketing loans are effectively export subsidies, as are some forms of food aid and export credits.

Doha Round Agricultural Agreement: What Is Possible?

- Eliminate all forms of ag export subsidies
- Reduce trade-distorting domestic subsidies (highest the most, but exceptions possible)
- Reduce tariffs (highest the most, but exceptions allowed if increase minimum market access)
- Accelerate economic growth in low income countries.

Free Trade Agreements vs. Multilateral Trade Liberalization

- FTAs are clearly second best – but often better than no liberalization (e.g. the huge success of free trade among the 50 United States!)
- Questionable tactic as practiced today
 - Generally leave out agricultural trade liberalization (“leave it for the WTO”)
 - Risk addressing other sectors’ problems and losing leverage from them in the WTO

WTO Ag Negotiations Hung Up on Who Goes First

- U.S. has proposed reducing its ag subsidies substantially, but only if other countries provide much greater access to their markets.
- The EU is proceeding with its reforms, including sugar, while the US reversed course in the 2002 farm Bill
- Developing countries won’t open their markets as long as world market prices are depressed by ag subsidies in OECD countries (and they have more than half of the votes in the WTO)
- Despite rhetoric at G-8 Summits, no more progress in WTO ag negotiations occurred this summer, and the negotiations were “indefinitely suspended.”

Prospects

- The next farm bill will be likely written in mid-2007 at about the same time as President Bush's fast-track negotiating authority expires.
- U.S. farm organizations will support a Doha Round Agreement that significantly reduces trade-distorting domestic subsidies *only* if the Agreement includes significant increases in market access.
- Key sticking points:
 - Will the E.U. be able to offer more agricultural market access than heretofore?
 - Will the U.S. be able to increase its offer?
 - Will Brazil and India offer more market access for services and non-ag manufactured goods?
- If not, the end of the Doha Round will not likely come during the Bush Presidency.

Remember

- The Uruguay Round Agreement on Agriculture will continue to set the rules of the road for international agricultural trade until some future round of negotiations changes them.
- If this round fails or is delayed, expect more cases to be filed with WTO against U.S. commodity programs. (No Peace Clause)
- The U.S. risks losing marketing loans, LDPs and CCPs through litigation and get nothing for giving them up. If we give them up in the round, we get something for giving them up.
- The round is not so much about reducing farm subsidies as it is about moving them from trade-distorting to non-trade-distorting mechanisms.