II. Trade Expansion Is Critical

...steadily expanding foreign demand—brought on by income gains, trade liberalization, and changes in global market structures—has helped U.S. exports steadily increase over time from $7.3 billion in 1970 to $53.5 billion for the current fiscal year.

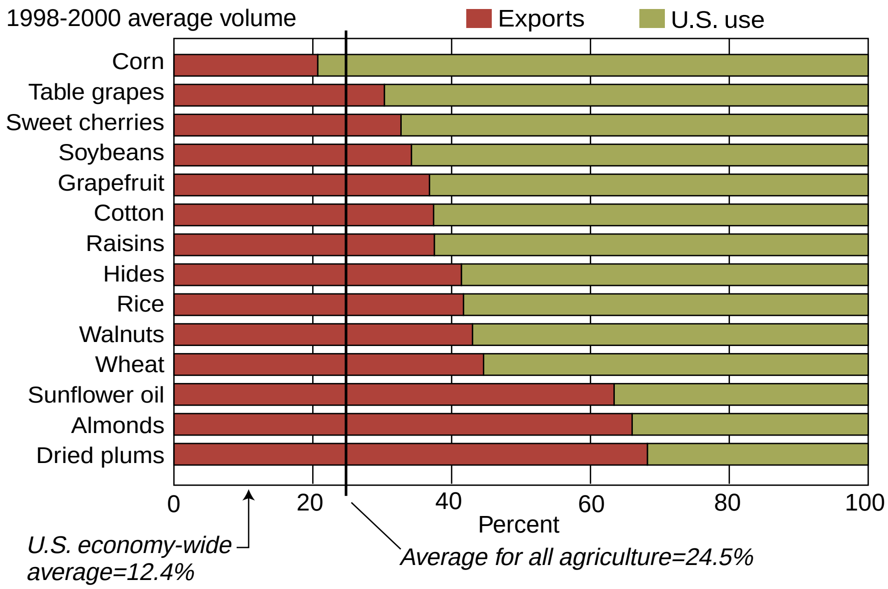
Trade continues to be critically important to the long-term economic health and prosperity of our food and agricultural sector. We have far more capacity than needed to meet domestic food market requirements. To avoid excess capacity throughout the system—our farmland, transportation, processing, financing, and other ancillary services—we must maintain and expand our sales to customers outside this country. In fact, our system's capacity grows faster than the domestic market alone can absorb. Given the maturity of our own food market, aggregate domestic demand has grown more slowly than the farm sector's rate of productivity growth. However, steadily expanding foreign demand—brought on by income gains, trade liberalization, and changes in global market structures—has helped U.S. exports steadily increase over time from $7.3 billion in 1970 to $53.5 billion for the current fiscal year. Clearly, without the salutary effects of an expanding export market, farm prices and net cash incomes would be significantly lower today.

The farm sector's reliance on exports can be further appreciated by observing the share of production of individual commodities exported each year. International markets take a large share of basic commodities such as wheat (45 percent) and soybeans (34 percent) as well as high-value processed products. Some high-value products, including almonds (66 percent) and sunflower oil (63 percent), rely on exports for well over half of sales. Overall, exports account for 25 percent of total farm sales (figure 10), double the percentage for the economy as a whole.

Agricultural exports also play an important role in the larger U.S. economy. Every dollar of direct export sales generates another $1.39

Figure 10

Exports Critical to Demand for Many Agricultural Products



in supporting economic activity. Processed products have even more extensive economic impacts than bulk commodities—$1.56 in supporting activity compared to $1.11. Exports also are not only important in providing jobs on farms, but also in food processing and in the transportation and trade sectors. Some 790,000 jobs were generated in 2000—318,000 on farms and 472,000 in assembling, processing, and distributing products for export. Overall, exports support jobs paying above-average wages.

Trade provides U.S. consumers with access to a wider variety of foods at reasonable prices, including those not produced domestically. Trade brings tropical fruits, coffee, and exotic French cheeses to American consumers. Imports make fresh fruits and vegetables, such as asparagus and grapes, available at affordable prices during winter months. U.S. food processors rely on global markets for many intermediate inputs, such as cocoa (combined with domestic sugar and dairy products) for chocolate.

Increasingly, as the food industry becomes globalized, it uses not just trade, but a variety of innovative business arrangements to access products from global markets and to sell services and products. Capital and technology now flow freely across national borders. U.S. producers move abroad to serve foreign markets and, increasingly, to sell those products here. Foreign firms are major players in our food markets, while U.S. firms sell widely abroad. By removing trade barriers, goods produced in the United States can be sold in foreign markets. But, if trade barriers remain, U.S. capital and technology will relocate to produce and gain access to these markets.

Developing and Middle-Income Markets

Over 96 percent of the world's population lives outside the United States—and that obviously is where food consumption growth will take place. Food demand in the United States and other developed countries—the mature markets—can be expected to increase only slowly, no faster than the rate of population growth. Most future growth in food demand will be in developing and middle-income countries, where both population and income are growing relatively rapidly. Almost all of the world's projected increase of 1.2 billion people by 2020 will be in these countries. As incomes rise, these consumers spend a far greater proportion of the extra money on food than do high-income consumers, who spend little.

Expenditures on food in developing countries still require a very large proportion of available incomes—47 percent on average compared to 13 percent for developed countries (and only 11 percent for the United States). This relationship that transforms income growth into large increases in food demand also makes the poor in developing countries vulnerable to food shortages from poor weather or economic crises and suggests a role for food aid (see box).

At very low incomes, cereals or grain make up most of consumers' calorie consumption, but as incomes rise above subsistence levels, consumers diversify their diets and

Food Aid

Food aid over the years has been used for a wide variety of reasons ranging from emergency situations to alleviate food shortages to promoting economic development. At any given time, short-term shortages, weather-related and/or human-made disasters (such as civil strife) create a need for food aid. Food emergencies such as assistance for refugees and displaced persons also are growing.

The United States is pivotal in the international food aid system, providing a significant share of all food assistance, and its actions have a major influence on other donors and the system as a whole. U.S. international food assistance is provided through a variety of programs, including PL-480, Section 416(b), and Food for Progress administered by USDA and USAID. The United States also provides food aid through the United Nations World Food Program, and through international non-governmental organizations (NGOs).

Management of food aid has become complicated because of the wide range of objectives. While all international donors cite humanitarian relief as the basic motivation, economic and political considerations also influence allocation. The mix of food aid usually reflects the export profile of the donor country and tends to vary with yearly fluctuations. Hence, while food aid clearly helped save lives during food emergencies in many countries such as Sudan, Ethiopia, Somalia, Rwanda, and Haiti, current patterns of supply and distribution are sometimes suboptimal in timing and benefits.

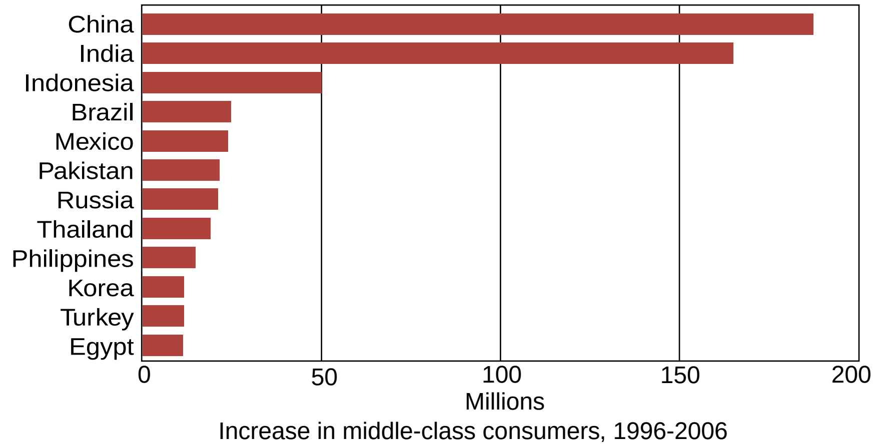
Several factors suggest this is an opportune time to review our food aid programs. Five years have passed since the World Food Summit in 1996 when the United States and developed countries pledged to reduce the number of hungry people by half by 2015. Some progress has been made, but the current pace will not meet the goal. Criticisms of food aid as interfering with the functioning of markets and reducing the incentive to local producers have been raised. New global trade negotiations and formulation of new domestic farm policies in several countries could be important venues for this review. In addition, all countries' food aid programs have also faced criticism that they interfere with the functioning of markets, reducing the incentive to producers.

purchase more meat and dairy products along with processed products. The growth in demand and diversification in diets by developing countries will have a dramatic impact on food markets in the next 20 years. The International Food Policy Research Institute (IFPRI) suggests that by 2020, 85 percent of the increase in the global demand for cereals and meat will occur in developing countries and that the demand for meat in the developing world could potentially double.

Across developing countries the "middle class," whose incomes have reached the level where consumers diversify diets by including livestock and processed products, is growing rapidly. Research in the mid-1990s indicated that there were some 900 million middle-class consumers in 19 key developing countries (figure 11). By 2006, that number is estimated to reach 1.5 billion, an increase of 68 percent and equal to the current combined population of Japan and the European Union. Much of that increase will be in China, India, and Southeast Asia but there will also be sizeable gains across Latin America.

Figure 11
Middle Classes in Key Emerging Markets To Grow by 600 Million

Transition from subsistence existence to "middle class" creates increased demand for quantity, quality, and diversity of food.



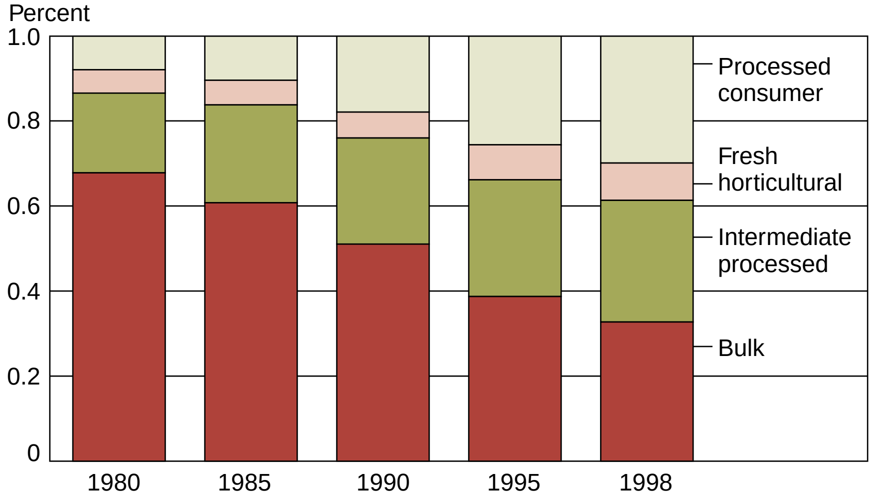
Growth in High-Value Exports

While we see growth in exports of basic commodities, exports of consumer-oriented, high-value products (meats, poultry, fruits and vegetables, and processed products) are growing even more rapidly (figure 12). High-value products now account for two-thirds of total sales, compared with only half in 1990.

Of the 20 fastest growing agricultural exports during the past decade, 15 were consumer-oriented, high-value products, with pet food leading the way. Pet food sales have grown almost 14 percent annually for a decade and this year are projected to reach a record 1 million tons valued at $1 billion. Continued expansion in these markets will require greater cooperation across the value chain—among farmers, ranchers, food processors, and others—to offer high-quality products at prices competitive with farmers and processors in other countries.

The positive outlook for high-value-product exports clearly benefits the Nation's bulk commodity producers. The sharp expansion in exports of red meats and poultry, especially relative to domestic sales, has increased the use of grain and soybeans to feed livestock (see box, page 40). We are exporting more corn and soybeans, but in the form of meat and poultry. In 1990, only 1.4 percent of the total value of our grain output and 1.8 percent of the value of our soybean output was exported as livestock products. In 2000, those numbers had grown to 4.3 percent for grains and 5.4 percent for soybeans.

Figure 12
Share of High-Value Products in U.S. Exports Growing Rapidly



Trade Expands Demand for Meat

In the last 15 years, U.S. export sales of the three major meats—beef, pork, and poultry meat—have grown faster than our competitors' meat exports, and the U.S. has evolved from primarily a meat importer to a large exporter. United States exports totaled $6.2 billion in 2000, compared with $3.7 billion in imports. Export quantity also exceeded imports (10 billion versus 4 billion pounds). On a value basis, the United States has become a net exporter of beef, pork, and poultry, with the value of beef exceeding $3 billion and pork and poultry each exceeding $1 billion. At the same time, we are the world's largest beef importer and a major pork importer. Expanding high-value meat export sales in the future benefits both processors and livestock producers, expands economic activity, and expands the demand base for both grains and oilseeds.

Barriers to Expanding Trade

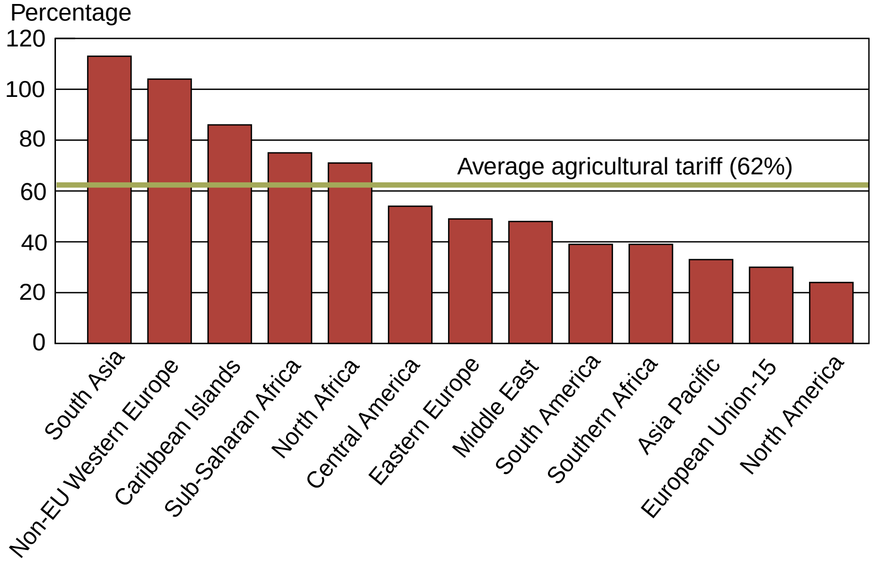
Although trade has become increasingly important for many products, U.S. exports have not kept pace with those of our competitors and, as a result, our market share has steadily eroded. Twenty years ago, the United States led exporters with a 24 percent share of global agricultural markets. That share has fallen to 18 percent and the European Union, with over 17 percent market share, has almost surpassed the United States. Some factors, such as a strong dollar that increases the relative price of U.S. exports, are beyond the scope of agricultural policy. But, U.S. exporters can benefit from international trade agreements to remove trade barriers and strengthened export promotion programs to keep pace with other countries' foreign market development initiatives (see box, page 41).

Lowering tariffs and other barriers to trade is fundamental to expanding exports. The average food and agricultural tariff is 62 percent, much higher than tariffs on manufactured items. Both developed and developing countries have high tariffs. Exports to the large potential markets in South Asia (including India) and to South America must overcome tariffs of 113 and 40 percent, respectively. The United States has one of the lowest food and agricultural tariffs, at 12 percent (figure 13), and thus stands to gain immensely from ambitious tariff cuts. However, the United States still maintains some high tariffs that protect specific commodities.

In addition to tariffs, high levels of domestic support for agriculture and export subsidies distort agricultural markets. In contrast to tariffs that are applied by almost all countries, developed countries account for virtually all domestic support and export subsidies. The Organization for Economic Cooperation and Development estimates that in 2000, developed countries' total support for agriculture was $327 billion. In that same year, total production supports by the European Union were $90.2 billion, compared to $49 billion by the United States. The European Union dominates use of export subsidies, accounting for approximately 90 percent of total annual spending since the Uruguay Round Agreement on Agriculture (URAA) took effect.

USDA research shows that removing all forms of agricultural protection and support could raise world prices 12 percent, over half of this from removing tariffs alone. Our producers and the industries they support could see the value of U.S. agricultural exports grow 19 percent. Global economic welfare would increase by $56 billion annually by removing existing distortions.

Figure 13
World Agricultural Tariff Averages, by Region[1]



[1]*Tariffs are bound MFN rates based on final URAA implementation.*

U.S. Falling Behind on International Market Promotion Spending

Since the URAA, our competitors, notably the EU and the Cairns Group, have increased their market development investments by 50 percent to $1 billion annually. In sharp contrast, our market development spending has been virtually flat at about $250 million. This is a sharp reduction from the early 1990s when Market Access Program funding fell from $200 million to the current $90 million.

A Trade Agenda for the 21st Century

America should continue to be a global agricultural leader in the 21st century. Our farmers and food companies benefit from a wealth of natural resources, cutting-edge technology, and a supporting infrastructure. With these assets, we can compete with anybody in the world—provided markets are open, trade is not distorted by subsidies, and our own domestic support programs do not inadvertently reduce our competitiveness. We also can and should employ America's agricultural bounty to meet the world's growing food aid needs.

Enhancing the competitiveness of U.S. food and agriculture in the global marketplace should be one of the primary objectives of our farm policy. To achieve this goal, we need to focus on four strategies:

- Continuing the liberalization of trade in agriculture
- Enhancing the competitiveness of our food and agricultural exports
- Ensuring we have the proper tools
- Pursuing an ambitious and focused global marketing strategy.

America should continue to be a global agricultural leader in the 21st century.

Continuing Trade Liberalization

Agricultural trade liberalization will expand access for U.S. food and agricultural products in overseas markets and reduce unfair competition in those markets from other countries. It would also promote economic growth globally, and particularly in developing countries where the demand for U.S. food and agricultural products has the greatest potential to grow.

A new round of World Trade Organization (WTO) negotiations would advance the process of trade liberalization. A new WTO agreement on agriculture is needed to continue the process of agricultural trade liberalization that was begun with the URAA. Signed in 1994, the URAA marked the first time that agriculture was subject to effective international trade rules. It establishes disciplines for the three major types of trade-distorting agricultural policies, frequently referred to as the three pillars of the URAA—market access (tariffs, quotas, and other trade barriers), domestic support, and export subsidies.

The URAA made substantial progress in liberalizing agricultural trade. However, much work remains to be done. Further progress in reducing and eliminating export

subsidies, market access barriers, and trade-distorting domestic support measures requires a comprehensive approach—all countries have to put all products and all policies on the table. There can be no exceptions.

Regional and bilateral trade agreements create export opportunities. They can be important building blocks for trade liberalization. The North American Free Trade Agreement (NAFTA), the United States' largest effort to date to completely eliminate trade barriers, has had promising results. Since the implementation of NAFTA, U.S. food and agricultural exports to Canada and Mexico have expanded by 59 percent, while corresponding exports to the rest of the world grew by only 10 percent. The Administration has committed to negotiating free trade agreements with Singapore and Chile, and eventually a Free Trade Area of the Americas encompassing virtually the entire Western Hemisphere.

Unfortunately, we have fallen behind some of our competitors. Today, there are more than 130 preferential trade agreements throughout the world—and the United States is party to only 2 of them (NAFTA and the U.S.-Israel Free Trade Area Agreement). The European Union has 27 preferential agreements with other countries and is negotiating 15 more. Both the EU and Japan are negotiating or exploring preferential trade deals with our Latin American neighbors, natural markets for U.S. food and agricultural products.

Free trade agreements should supplement, not substitute for, global trade liberalization. They can accelerate the pace of liberalization and provide momentum for global reform, but they also have limitations. Trade distortions caused by export subsidies and domestic supports cannot be effectively addressed in free trade agreements. Nor should the basic rules governing global agricultural trade established in the WTO be altered in free trade agreements.

Enforcement will help to maximize the benefits from trade agreements. As part of the Uruguay Round, WTO members agreed to a strong dispute settlement process. The United States has been involved in nine agriculture-related cases brought to dispute settlement panels and has prevailed in seven. Nevertheless, the number of disputes in the WTO continues to grow, creating demands on resources for both the government and industry. The prospective entry into the WTO of China and Russia—countries without strong market systems in place—will present even greater enforcement challenges.

While the dispute settlement process has been an important tool, intervention to prevent trade disputes before they reach the WTO will be critical to protecting U.S. agricultural trade interests in the future. Effective prevention requires constant monitoring of U.S. export markets. The U.S. agricultural attaché network, working closely with U.S. exporters, can serve as an early warning system for potential trade problems.

A critical success of the Uruguay Round was the establishment of effective rules to prevent domestic regulations to protect food safety and plant/animal health from being used as disguised trade barriers. Under the Sanitary and Phytosanitary (SPS) Agreement, countries committed to using science as the basis of domestic regulations and to subjecting their regulations to scrutiny through the WTO dispute settlement process.

The United States is as rigorous as any country in basing its regulatory decisions on sound science. However, our regulatory infrastructure is struggling to keep pace with the increase in the number of technical barriers to trade. The growing number of SPS regulations around the world related to biotechnology

A critical success of the Uruguay Round was the establishment of effective rules to prevent domestic regulations to protect food safety and plant/animal health from being used as disguised trade barriers.

We must ensure that our exporters have the necessary tools to capture a greater share of the benefits that are flowing from trade reform and the resulting global market expansion.

present a particular challenge, both for our infrastructure and for our food and agricultural exports. To meet these growing challenges we will need more resources in our regulatory agencies; more research and technology development for disease and pathogen control; and, just as importantly, resources to train regulatory officials in other countries to help ensure that their regulations are based on sound science.

Enhancing Export Competitiveness

As agricultural trade is liberalized, the competition in the global marketplace will become increasingly fierce. Trade liberalization alone will not guarantee success in export markets. We will have to sell what our customers are demanding and on better terms than our competitors.

The United States has abundant natural advantages in agriculture that will allow us to continue to be an agricultural superpower. However, to remain competitive, our domestic farm programs must be complementary with our international trade objectives. Producers need flexibility to adapt rapidly to the changing demands of the marketplace. Our support policies should provide an economic safety net without distorting market signals. Given the rapid growth in high-value-product exports, food processors and manufacturers need access to their raw materials at world market prices. In short, we have to expand our vision from supporting farm prices to participating in the global marketplace.

Providing the Proper Tools

We must ensure that our exporters have the necessary tools to capture a greater share of the benefits that are flowing from trade reform and the resulting global market expansion. USDA provides support for overseas market expansion through both infrastructure, such as the agricultural attachés overseas, and assistance programs, such as export credit and credit guarantee programs.

Exporters receive assistance from a trade infrastructure that includes agricultural offices in 63 posts covering 130 countries. Agricultural attachés serve on the front line of U.S. food and agricultural trade, working with foreign governments to eliminate unfair trade barriers, responding quickly to market access problems, and monitoring compliance with trade agreements. The attachés overseas and the staff in Washington help exporters expand current markets and break into new markets through continuous reporting of trade information and by assisting with trade promotion activities. They also help to overcome barriers posed by different cultures, languages, and preferences for food.

Export promotion assistance allows firms to establish footholds in profitable markets that otherwise might have been inaccessible. With the Market Access Program (MAP), USDA targets consumer-promotion and trade-servicing activities toward markets for value-added and processed products. Commodity and agricultural trade associations can use the Foreign Market Development (FMD) program to acquire market research and surmount long-term impediments to trade.

USDA programs to guarantee financing for trade have expanded exports by providing developing and middle-income countries with access to credit. Recent success in using export credits to finance food imports by countries during the Asian financial crisis demonstrates the ability of these programs to maintain demand for U.S. products. However, these programs have been sharply criticized by some countries as unfair subsidy practices, although the United States is not alone in maintaining export credit programs. As we look to the future, we will have to consider the feasibility of developing international disciplines on the use of government-supported export credits.

Focusing Our Marketing Strategy

USDA's export assistance activities should be focused on those markets with the greatest growth potential. While we cannot afford to ignore any market, neither can we provide the same level of assistance and attention to all markets.

Principles for Expanding Trade

- **Recognize the critical importance of the global marketplace.** More than 96 percent of all consumers live outside the United States. Failing to reach the newly emerging middle-class consumers (where demand growth will be most rapid) will stifle expansion of market share.
- **Expand markets through new trade agreements.** Greater access to foreign markets requires aggressive trade policy to lower tariffs and eliminate distorting subsidies. Failure to provide strong leadership in global trade liberalization will result in our producers and exporters being left behind. Other nations are aggressively pursuing agreements, many right in this hemisphere which are markets where we should have transportation and other advantages.
- **Ensure that farm and trade policies are fully compatible.** Domestic farm support and international trade policies must be consistent and mutually reinforcing. It makes no sense to have trade policies and programs promoting farm exports at the same time domestic support programs inadvertently reduce competitiveness. Our domestic and export policy must support our existing international obligations and at the same time give us ample latitude in pursuing ambitious goals in ongoing and future negotiations.
- **Enforce existing trade agreements.** Once new trade agreements have been concluded, the Government must ensure that our trading partners meet their obligations. This includes ensuring that our trading partners use accepted scientific principles in enacting their regulations. The growing number of sanitary/phytosanitary-related trade issues also requires an enhanced regulatory infrastructure.
- **Sharpen marketing efforts.** Programs to expand exports—export credit guarantees and market development—have served our food and agriculture sector well. Continual review and modification of these programs are required to ensure they are cost-effective and target high-impact growth markets and high-value products.