MEMORANDUM FOR: C/NIC
DDI
DCI

An outstanding INR paper. They have a first rate agricultural economist.

Maurice Ernst
NIO/Econ

Date 21 January 1983

FORM 5-75 101 USE PREVIOUS EDITIONS

GPO : 1981 O - 345-783

Approved For Release 2008/10/06 : CIA-RDP85-01156R000100050041-7

Chron

UNCLASSIFIED

NIO/ECON

DEPARTMENT OF STATE • UNITED STATES OF AMERICA •

BUREAU OF INTELLIGENCE AND RESEARCH

ASSESSMENTS AND RESEARCH

LOW WORLD FARM PRICES TO PERSIST

Summary

The world's agricultural exporters face a bleak picture. Technology and investment continue to raise world farm output while consumer demand has been hit by economic stagnation. As a result, farm export earnings are down sharply, and international farm trade problems are flaring into open warfare.

The real price of sugar has just hit a 10-year low. The world's grain carryover this year will be the biggest in history--despite crop failures in the USSR and Australia. World animal feed production will set a record, but hard-pressed consumers cannot afford more meat. The coffee surplus is reemerging, and the cocoa surplus continues.

The agricultural boom of the 1970s was created by the demand for livestock products. This required major increases in production of feed grain and protein meal, which are the raw materials for meat, milk, and eggs. World grain and oilseed markets have lately lost virtually all their growth as world meat consumption has plateaued and even fallen in some important markets, owing to weak consumer buying power. At the same time, production cycles and investment have created current or prospective surpluses for many other important farm export commodities including meat, dairy products, sugar, coffee, cocoa, and cotton.

Farm exporters probably will continue to be burdened with a general surplus of agricultural output until economic recovery regenerates growth in the effective demand for livestock products.

* * * * * *

UNCLASSIFIED

Report 527-AR
January 4, 1983

Rising Production

The world is currently turning out record or near-record crops of wheat, coarse grains, rice, sugar, and dairy products. Heavy carryovers have been depressing prices in grain, sugar, cocoa, and cotton. Meanwhile, increases in farm output are still being encouraged by:

--past investments in irrigation, land development, and marketing infrastructure;

--continued adoption of new farming technology;

--some decreases in the costs of important production inputs, especially fertilizer, the price of which has dropped more than 20 percent on the world market in recent months;

--the critical need in many countries to maximize foreign exchange earnings from farm exports;

--the equally critical need in some food-importing countries to maximize domestic food production and thereby conserve foreign-exchange spending on food imports; and

--major national programs that encourage surplus farm production and/or suppress consumption (high price supports in the European Economic Community--EEC--and import quotas in Japan are perhaps the largest of these distortions).

Farm production costs have fallen somewhat from their recent highs. Fertilizer and interest rates are down and the chemical and farm machinery industries have excess capacity. Despite these lower costs, the sharp drop in prices for farm output means that farmers in many countries are suffering from reduced incomes. As a result, real farm land values in the US have dropped some 20 percent since 1980.

Agricultural Expansion To Continue

A number of countries are pursuing what they perceive to be long-term comparative advantages in agricultural production. For example:

--Canada is making major investments in hopper cars and west coast port facilities to raise its west coast export capacity from 23 million metric tons (mmt) per year to 30 mmt annually by 1985-86. The Canadians also have repealed an outdated rail rate which had discouraged railroads from hauling grain west and have signed larger grain sales agreements with the USSR, China, Brazil, and Algeria.

--Brazil has expanded production in a broad array of export products--including soybeans, sugar, cocoa, orange juice, beef, and poultry. Brazil also expects to resume its annual 30-35 million bag level of coffee production, up from the 17-25 million bags produced in 1976-81.

--Malaysia is developing more of its tree crop potential, including rubber, palm kernel, and cocoa.

--Thailand has sharply increased its output of rice and feed-stuffs (primarily corn and manioc) and is rapidly extending its network of farm-to-market roads.

--High European Common Market price incentives are continuing to stimulate EEC farm production. United Kingdom grain production in 1982, for example, will be up some 2 million tons, owing to higher yielding varieties and a shift from spring to winter barley. EEC dairy production is rising by 6 percent per year.

--China, which had been concentrating on increasing grain production at any cost, is encouraging more production of other crops. China's overall farm productivity is expanding rapidly as a result.

--Nicaragua is completing a new sugar mill and plans two more to increase export earnings.

--Australia is expanding plantings of grain sorghum, to take advantage of the expected long-term growth in world feed demand, and of sugar, because of relatively low production costs in its tropical northern region.

--Pakistan continues to broaden its use of high-yielding seeds and fertilizer and has now become an exporter of both wheat and rice.

Slumping Demand

A demand for better diets--especially the demand for more livestock products--fueled the agricultural boom years of the 1970s. A kilo of bread takes essentially a kilo of grain to produce. But if the grain is fed to a chicken, it takes at least 2-1/2 kilos of grain to produce a kilo of food. A kilo of pork requires 5-6 kilos of feed. The feed requirement for beef varies greatly with the forage ratio in the animal's diet, but beef unquestionably requires far more farming resources per human calorie than bread. This livestock multiplier has sharply increased world farm product demand in recent years as economic growth has permitted millions of additional consumers to afford more livestock products in their diets.

From 1970 to 1980, when the world's population was rising 20 percent, world meat production rose 42 percent. Trade in feedstuffs increased by 130 percent (93 mmt) in order to supply the raw materials for the increase in meat production. By contrast, trade in wheat used directly as food--rather than for meat production--increased only about 60 percent.1/

Since 1980, however, economic growth has slowed sharply in the world. A doubling of oil prices in 1979, the lack of foreign exchange of East European countries (which were borrowing to finance a large volume of feed imports), and a plateauing of meat consumption in countries where it had been growing rapidly (such as the USSR, Spain, Taiwan, and Japan) all played a part in the slowdown. Moreover, meat consumption has fallen significantly in the past three years in such important markets as the US, Australia, and Canada. As a result, feed grain trade--even with high Soviet grain imports--has increased only about 5-7 mmt per year since 1980. Surplus production is now being stockpiled at great expense instead of being converted into high-value foods.

Trade Barriers Intensify Problems

The EEC, which formerly imported about 20 mmt of grain per year, now exports perhaps 5 mmt--in large part because of its highly protective Common Agricultural Policy. In addition, high EEC food prices have constrained consumption. This year the EEC is expected to spend $13 billion on its farm support program--and export the resulting surpluses of wheat, flour, sugar, butter, nonfat dry milk, red meat, and poultry at the expense of other sellers.

Japan has also followed a protectionist farm policy. Its import quotas foster high internal prices for many foods. High meat prices, for example, indirectly limit Japan's feedstuffs demand: In the mid-1970s, Japan and Taiwan had similarly low per capita meat consumption, but Taiwan's consumption has since risen to 20 percent more than Japan's. Estimates suggest that if meat

1/ Because the Soviet Union produces enough wheat for its own bread and other direct cereals consumption, its imports are basically to support its livestock production.

consumption in Japan rose to the Taiwanese level, Japanese demand for feed grain would increase by about 4 mmt per year.

High-cost producers of beet sugar are protected in such major markets as the EEC, the US, and Japan. Along with substitution of corn sweeteners, sugar protection is one of the major price-depressing factors in the world sugar market, particularly in the case of the EEC where it has encouraged a massive increase in sugar exports in recent years.

With world farm export markets under such intense pressure, trade issues are being contested much more fiercely:

--More than a dozen nations have joined in formal protests against the EEC's Common Agricultural Policy.

--The US Congress has authorized farm export subsidies for the first time in nearly a decade--and has even threatened to dump its surplus dairy products in retaliation against EEC subsidies.

--The EEC is counterattacking with threats to slap duties on US soybeans and such nongrain feedstuffs as corn gluten feed.

--Producer members of the International Coffee Agreement are contending for larger shares of the coffee quota; millions of new coffee trees may soon produce a potentially huge coffee surplus.

--The French Government is offering below-market financing for grain sales that in most years would require cash payment.

--Japan's tight restrictions on farm imports are again under attack.

International Commodity Agreements

International commodity agreements are under extreme pressure. The International Sugar Agreement faces a big world surplus largely caused by:

--subsidized beet sugar production in some developed countries;

--increasing competition from substitutes, especially high-fructose corn sweetener; and

--large production increases stimulated by high world prices in 1980.

The agreement has been unable to keep prices within its agreed price band.

The coffee industry faces a huge surplus in coming years as expanded coffee plantings, put in after the disastrous Brazilian freeze of 1975, clash head-on with resurging production from 350 million new trees in Brazil. Consumer demand is virtually stagnant. The International Coffee Agreement will face increasing pressure as importing countries are forced to hold even larger excess stocks.

The International Cocoa Agreement has been struggling for the past two years with a large cocoa surplus encouraged by the high prices of the late 1970s. The Ivory Coast, the world's largest cocoa producer, has refused to join the agreement because it believes the agreement's price targets are too low. On the other hand, the US, the world's largest consumer, also has refused to join because it believes the price targets of the agreement are unrealistically high. Market prices have been well below the lower intervention price of $1.02 a pound.

The International Rubber Agreement is less than a year old and already in deep trouble with weak prices, a fast-growing buffer stock, and sharp internal disagreement.

Outlook

The price outlook for most agricultural commodities remains bleak for at least the next year.

World agricultural production will probably continue to increase in the near future at least as rapidly as it has in the past. Should the Soviet Union get a good grain crop, world farm production could soar to new highs. New land has continued to come into production in Brazil and Argentina, and there is a great deal more farmland available in such currently remote areas as the Amazon and Sudan. Most of the world's farmland is also being used more intensively with higher yielding seeds, heavier fertilization, newer machines, and better pesticides. Such new investments as irrigation wells, sugar projects, and tree planting will add production in the years ahead. Competition from substitute and synthetic products will also continue to be stiff, especially in sugar and hard fibers.

Long-term factors affecting demand are increased population and economic development. Much of the population growth, however, is in countries with weak buying power. It will be several years before the East European economies achieve enough growth to become good farm customers again. The Soviet Union will continue to be a major importer, but its purchases will be erratic. Many of the less developed countries (LDCs) will increase their farm product imports in future years to improve their diets--but only after they have improved their trade balances.

Moreover, the huge consumer markets in the EEC and in Japan remain largely hidden behind protective walls. These walls may gradually crumble--in the EEC because of high budget costs and in Japan because of the overriding need for market access for its own industrial exports. The process, however, will probably take years.

For the immediate future, world farm production will continue to outstrip effective demand, as most farming resources cannot be refocused in the short term. Thus, agricultural prices will remain under severe pressure on a broad front, perhaps for several years.

Prepared by Dennis T. Avery
x28600

Approved by Emil P. Ericksen
x22186

APPENDIX

Commodity-by-Commodity Outlook

Grain

Total world production of wheat and coarse grains in 1982-83 will increase by nearly 60 mmt over 1980-81, while demand for livestock feed is slacking off because of worldwide recession. World rice production continues to set records as additional farmers adopt "Green Revolution" technology and new varieties. Carryover grain stocks are projected to reach 238 mmt by the end of this year--equal to 16 percent of annual consumption, compared with a recent average of 14 percent and a recent low of 12 percent in 1980-81.

The short-term outlook for grain prices continues to be bearish. Stocks will rise this year despite a Soviet crop at least 40 mmt short of "normal" and a drought in Australia that is cutting grain production another 8 mmt. Grain prices are unlikely to recover soon, barring crop disasters in the world next year or a sharp economic recovery with resurging demand for meat.

Key Players

USSR. The Soviet crop is the largest variable in the world grain outlook. Soviet grain crops have recently ranged between 170 and 230 mmt.

US. American farmers have made the largest response to rising world feed demand, raising their annual cereals production by as much as 100 mmt since 1970. The US is trying to reduce farmers' plantings through land diversion programs while it still supports farm prices slightly above market-clearing levels.

Canada. Canadian farmers have increased annual grain output by more than 15 mmt in the past three years. Government programs are now aimed at increasing Canada's share of the world grain market again through aggressive pursuit of long-term sales agreements and expanded grain-handling capacity.

Argentina increased its grain production by 3.5 mmt over the past three years, stimulated by a long-term sales agreement with the Soviet Union.

Thailand planted an additional 500,000 hectares to feedstuffs in recent years, primarily corn and manioc. The Thais have just agreed to limit manioc marketings in the EEC and are looking for alternative crops or markets.

Rice Producers. Rice production has been rising significantly in China, Brazil, Burma, Indonesia, Thailand, and the Philippines.

Oilseeds

World oilseed production will reach a record high in 1982-83, 7 percent more than last year. Soybean production has risen the most rapidly in recent years. Rapeseed increases have also been significant with some increases in sunflower seeds, palm kernels, and peanuts. Oilseed prices are likely to stay at low levels at least until the recovery of industrial economies stimulates increased demand for meat and feedstuffs.

Key Players

US. Annual soybean and sunflower seed production has increased 16.3 mmt over the average of the late 1970s.

Brazil. Sharp increases in soybean yields and some increase in peanut production will raise 1982-83 oilseed production 1-1/2 million tons higher than 1978-79.

Argentina has significantly increased soybean and sunflower-seed production.

China. Emphasis on cash crops has recently raised Chinese production of soybeans, cottonseed, peanuts, and rapeseed by two-thirds.

EEC. The Community, under the stimulus of high price supports, has nearly doubled rapeseed production in the past three years. Spain, preparing for EEC membership, has more than doubled its rapeseed production.

Sugar

Recent trade estimates put 1982-83 world sugar production at 97.5 mmt, below last year's 99 mmt record but still well above expected world consumption. Global carryover stocks currently represent more than 30 percent of annual demand. Consumption has increased slowly--about 2.9 percent per year.

Key Players

Cuba. Severely hurt two years ago by an epidemic of cane rust, Cuba's production has reportedly recovered to a more normal

8.2 mmt this year. Cuba remains dependent on sugar earnings and must export as much as possible.

Australia continues to expand its highly efficient sugar production in the tropical northern zones.

EEC high price guarantees to producers (currently about 21-22 cents per pound) have produced a potential surplus for export in 1982-83 of more than 6 mmt (though the EEC has pledged to ship no more than 5 mmt).

Coffee

After Brazil's tree-killing frost of 1975, coffee prices rose to record highs and sent the world on a coffee-planting binge. Now the expanded plantings in such countries as Colombia, Indonesia, and Ethiopia are running head-on into the expected Brazilian recovery. The coffee market was temporarily saved by another, milder frost in Brazil which cut production from 33 million bags in 1981-82 to about 17 million this year. Even so, the International Coffee Organization had to impose three quota cuts during the past year to keep the price above the minimum $1.20 per pound.

Demand has been declining slightly despite the low prices. Next year, with Brazil likely to produce more than 30 million bags, and even more (high-yielding) new trees coming into full production in other countries, coffee prices will be under tremendous downward pressure.

Key Players

Brazil. Brazil's coffee year is different from that of other producers: the US Department of Agriculture estimates Brazil's production: 1981-82 (last year) 33.0 million bags; 1982-83 (this year) 18.0 million bags; 1983-84 (next year) 30-35 million bags.

Colombia. Recent production is up nearly 50 percent to 13.5 million bags--mostly the higher valued mild types.

Southeast Asia. Formerly bit players, producers in the region have nearly doubled their production since the mid-1970s. Indonesia has the largest plantings with India, the Philippines, Thailand, and Papua New Guinea also making large proportional gains.

Africa. Ivory Coast, Kenya, and Ethiopia have increased output. Angola and Uganda, on the other hand, have lost significant production because of internal strife.

Central America. Costa Rican production is up, but production in other Central American countries is stagnant or declining owing to coffee disease problems and political instability.

Cotton

Slack demand from recession-hit textile industries and continued expansion of Asian cotton production has softened world cotton prices. While US producers cut 1982 plantings sharply in response to the lack of price incentives and Central American producers cut back because of civil disturbances, Chinese, Indian, Pakistani, Brazilian, Australian, and Burmese producers expanded sharply. This trend continues a long-term shift of cotton production to LDCs. Prices may strengthen with economic recovery in the industrial countries.

Key Players

US. Long the world's cotton production leader, it has now been surpassed by China and the USSR.

China. Cotton output has risen nearly 50 percent in the past three years to 4.5 million bales. Both plantings and yields are increasing.

Pakistan. Much higher yields have increased production 42 percent in two years.