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DIRECTORATE OF INTELLIGENCE

19 NOV 1986

MEMORANDUM FOR: See Distribution List

FROM: [redacted] 25X1
Director of Global Issues

SUBJECT: New Third World Agricultural Competitors: The Growing Challenge (An Update) [redacted] 25X1

1. The attached memorandum updates a recent research paper on the same issue. Preliminary trade data for 1986/87 and additional intelligence reporting indicate that the Third World agricultural challenge identified in that paper is continuing to increase, stimulated by increased use of market incentives, application of advanced agrotechnology, and natural comparative advantages. [redacted] 25X1

2. This memorandum was prepared by [redacted] Economics Division, Office of Global Issues. [redacted] 25X1

3. Your comments and suggestions on this memorandum are welcome [redacted] 25X1

Attachments:
[redacted] 25X1
GI M 86-20259, November 1986

[redacted] 25X1

[redacted] 25X1

[redacted] 25X1

SUBJECT: New Third World Agricultural Competitors: The Growing Challenge (An Update) [redacted] 25X1

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DIRECTORATE OF INTELLIGENCE

18 November 1986

New Third World Agricultural Competitors: The Growing Challenge (An Update) [redacted] 25X1

Summary

Competition in agricultural trade will accelerate in coming years. Evidence acquired since our report in September on new Third World agricultural exporters strengthens our conclusion that structural change in the form of advances in technology and shifts by LDC governments toward more market-oriented farm policies will substantially expand Third World competition with the United States in key product areas. The market position of current major LDC competitors such as Brazil, Thailand, and Malaysia remains strong, and new data show continued efforts by other LDCs to boost their agricultural export capacity. Despite depressed global price prospects, LDCs continue to encourage ag production by reforming their economies in order to garner scarce foreign exchange to service debts, boost domestic economic activity and self-sufficiency, and restructure inefficient economic sectors. These changes should brighten overall economic prospects in many LDCs while further depressing global commodity markets. [redacted] 25X1

This memorandum was prepared by [redacted] Trade Issues Branch, Office of Global Issues. This analysis is based on information received as of 4 November 1986. Comments and queries are welcomed [redacted] 25X1 25X1

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NEW THIRD WORLD AGRICULTURAL COMPETITORS: THE GROWING CHALLENGE (An Update)

Introduction

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[redacted] 25X1 we identified structural changes in the agricultural sectors of many LDCs that favor market-responsiveness and comparative advantage. These advances have taken the form of shifts to more market-oriented agricultural policies and progress in agrotechnology. The changes have been motivated by several factors facing LDCs:

- o The necessity to improve balance of payments that depend heavily on foreign exchange earned by agriculture.

- o The fact that agriculture still accounts for a large share of domestic incomes and employment in most developing countries.

- o IMF-mandated adoption by debt-troubled LDCs of growth-oriented macro-economic and structural reforms as a prerequisite for reducing debt servicing burdens over time.

- o A growing recognition by many LDC governments that stronger economic growth in general requires market-oriented reforms to cut inflation, reverse capital flight, and restructure inefficient economic sectors.

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[redacted] 25X1

o Reaction to the heavy structural burden of inefficient or highly-subsidized public enterprises. [redacted] 25X1

Where Key LDCs Stand

In line with these structural changes, the new and emerging agricultural competitors we have identified have continued previous reforms, and many have made additional policy changes to encourage export development. These changes [redacted] have allowed the gains for the leading LDC exporters to continue unabated: 25X1

o Brazilian earnings from soybean meal exports for January through September 1986 topped $1 billion--20 percent above 1985 levels, according to US Embassy reporting. Orange juice export earnings are also above 1986 levels.

o Malaysian palm oil production is expected by trade sources to reach 5.0 million tons in 1987--6 percent above this year (see Table 1)--while Indonesian output is predicted to jump 25 percent. Production should continue to expand in both countries as government and private estates improve their yields and expand the land area under cultivation. Kuala Lumpur officials predict annual Malaysian palm oil production will reach 9 million tons by the year 2000.

o Thai rice exports are now predicted by USDA to reach a near-record 4.3 million tons in calendar-year 1987--8 percent above 1985 levels.

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Table 1
New Third World Agricultural Competitors
Production and Exports of Selected Commodities
(in 1000 Metric Tons)

	1975/76	1985/86	1986/87[a]
Brazil			
Soybean			
Production	9,892	13,400	**16,500**
Exports	3,516	1,300	**2,000**
Soybean Meal			
Exports	4,078	7,450	**7,600**
Soybean Oil			
Exports	430	600	**700**
Frozen Concentrated Orange Juice (FCOJ)			
Production	211	771	**844**
Exports	181	730	**725**
Poultry			
Production	569	1,590	**1,800**
Exports	71	251	**274**
Malaysia			
Palm Oil			
Production	1,258	4,730	**5,000**
Exports	1,160	4,108	**4,325**
Cocoa			
Production	15	120	**160**
Exports	14	110	**150**
Thailand			
Rice (milled)			
Production	10,098	12,705	**12,510**
Exports	933	4,200	**4,300**
Rubber			
Production	355	720	**780**
Exports	342	648	**702**

[a]Forecast
Source: USDA/FAS and Industry Reports

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Similarly, Thailand's rubber production is soaring, and exports are expected to reach 700,000 tons this marketing year and 964,000 tons by the year 2000, according to US Embassy reports. 25X1

The more recently emerging exporters are also faring well, spurred largely by additional inputs and opportune tax reforms:

o <u>India</u> is attempting to market 1 million tons of surplus rice and 2 million tons of wheat, according to Embassy reports. India's good agricultural performance is attributed to the addition of over 2 million hectares of irrigated land annually for the past 5 years, a 70 percent increase in fertilizer consumption in 1986 over 1980 levels, and increased availability of loans to farmers.

o <u>Indonesian</u> Agriculture Minister Affandi hopes to boost 1987 rice production another 2 percent over this year's harvest level of 26.6 million tons, according to press reports.

o <u>Argentina</u> has the potential to increase its grain and soybean exports 40 percent by 1990, according to USDA. Sales could surge further if the Alfonsin government eliminates taxes on agricultural exports and spends money improving the marketing system. 25X1

Even in Africa, where we believe agricultural productivity generally will remain low for the forseeable future, several countries have achieved considerable gains:

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- o **Zambia** has produced bumper corn crops this year and is fast approaching self-sufficiency in basic foods. Vast tracts of unused land, plenty of water for irrigation, and abundant manpower offer promise for the future, and there is increasing interest in exporting tobacco, coffee, and cotton. According to press reports, coffee exports--only 600 tons in 1986--may jump to 6000 tons by 1990.

- o Kenya will have a second consecutive record grain harvest in the 1986/87 crop year--mostly corn and wheat--according to Embassy officials. This is due largely to good seed supplies, excellent producer price incentives, and favorable weather.

- o Zimbabwean exports of major farm products--corn, cotton, and tobacco--jumped 25 percent above the previous five-year average to 1.8 million tons in 1986, though transport problems may disrupt future exports because of South African retaliation against Zimbabwean or Western economic sanctions. The key to Zimbabwe's agricultural success has been a shift by government extension services to focusing on small, black-owned farms. Approximately 2000 government agents now provide information on pesticide and fertilizer application as well as hybrid seed development. 25X1

Government-Backed Incentives

Appropriate producer incentives have given a strong boost--in most cases--to export advances. Many of the successful LDC exporters are

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continuing to curtail or eliminate subsidies on farm inputs, reduce state intervention in marketing, and improve prices for farm products:

- o Brazil's new economic plan calls for investment in infrastructure including rail expansion, port improvements, and a near-doubling of irrigated hectarage to 2.8 million by 1989. While the major emphasis of the agricultural package is to increase crop production for domestic use, this newly-productive land has the potential to increase grain and soybean production by over 7 million tons annually--and boost export supplies as well.

- o Malaysian Finance Minister Daim intends to boost exports further through a planned reduction in crude palm oil export duties by 20 percent to a maximum rate of 30 percent, according to Embassy reports. In addition, the export refinancing scheme will be extended to rubber, palm oil, and palm kernel oil exports, and the period of financing will be extended from 90 to 180 days.

- o Thailand has recently built a bridge and several access roads to link the mainland with two rubber-producing islands--the first of three major infrastructure projects underway. The new span will provide the main rubber center of Hat Yai with easy access to major ports. Still to be completed are deep-water ports in Songhla and Phuket. According to Embassy reporting, the new Songkhla facility will boost Thai rubber exports and stimulate regional growth. 25X1

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Similarly, newly emerging exporters are reaping the benefits of reduced state intervention, improved pricing policies, and infrastructure development:

- o Indonesian palm oil exporters should benefit from the recent devaluation of the rupiah as black market activity diminishes. According to local exporters, the export price for crude palm oil has already risen to $.22 per kilo, up from $.17 before the devaluation.

- o Indian deregulation of markets and unrestricted access by millers to wheat supplies will accelerate expansion of the flour milling industry, [redacted] and provide new opportunities for US exports of processing technology and equipment. 25X1

- o Philippine leaders are planning major infrastructure developments, including road building and irrigation improvement. Farm sector growth will eventually be promoted through abolishing agricultural industry monopolies, establishing a flexible exchange rate policy, and rehabilitating the rural banking system. In addition, plans for selective price supports and crop insurance are designed to promote agricultural investment.

- o Zimbabwean producer prices for corn--$104 per ton--have been so successful that the country now faces storage problems for its 2 million ton surplus and is aggressively seeking export markets [redacted] 25X1

- o Gambia has steadily increased producer prices for groundnuts, cotton, and

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rice since 1982. In addition, the fertilizer monopoly has been abolished and cereal crop marketing is now in the hands of private traders.

- o <u>Zambia</u> has decontrolled the producer price of corn for the 1986/87 marketing year and allowed farmers to sell directly to millers and food processors instead of state buying agencies, leaving the inefficient parastatal NAMBOARD the buyer of last resort.

- o <u>Pakistan</u> has been able to sell its entire cotton crop, the first time this has happened in recent years. Through competitive pricing and quality improvements, the Pakistani Cotton Export Corporation sold 3 million bales (about 700,000 metric tons)--largely to Taiwan, South Korea, and Japan.

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- o <u>Colombia</u>, though not a major exporter, has reduced government interference in its import, export, and foreign exchange systems and has implemented more market-sensitive agricultural policies, according to US Embassy reporting. 25X1

<u>Technology</u>

LDC policy reforms in the farm sector also have been augmented in many cases by the expanded use of agrotechnology. These efforts suggest further gains in farm productivity in coming years as LDC expenditures on research and agricultural extension programs are increased:

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o Brazilian researchers are developing viral-based insecticides for sugar cane and soybeans that can control pests more cheaply and efficiently than chemical pesticides. Another private research firm is spending $4 million on a genetic engineering project to improve yields and quality of various foodstuffs, according to Embassy reports.

o New hybrid rice varieties developed by the International Rice Research Institute (IRRI) have performed well on irrigated land in South Korea, Malaysia, Philippines, Indonesia, Sri Lanka, Pakistan, and the Punjab in India. Experts estimate that rice yields could be improved another 80 percent by increasing the total dry matter of the plant through genetic engineering to allow the plant to convert sunlight into carbohydrates more efficiently.

o Argentina has used new corn varieties that resist cool weather and mature three weeks earlier than conventional hybrids to begin planting corn further South, according to press reports.

o Sudan's new hybrid sorghum strain which is pest and drought resistant has contributed to grain surpluses in 1986. Improved maize varieties, combined with improved agricultural policies, have contributed to grain surpluses in Kenya, Zimbabwe, and Malawi.

o Bangladesh now grows over 200,000 hectares of wheat--ten times the acreage harvested before the advent of modern high-yielding varieties, according to press reports.

[redacted] 25X1

- o Turkey--which increased farm productivity by one-third between 1970 and 1982--is building three new dams in the upper Euphrates Valley to establish irrigation systems that will add over 8 million hectares to the cropland base, according to State Department analysis. [redacted] 25X1

Implications

The rapid growth of LDC agricultural exports that stems from structural reforms and wider use of technology presents both opportunities and obstacles for the United States. On the positive side, rapid agricultural growth in LDCs will create future markets for US exports:

- o Pakistan, for example, is expected to import 50,000 tractors and other farm implements in 1987 and order significantly more combines and food processing and packaging machinery over the next few years, according to State reporting.

- o Malaysian Primary Industries Minister Leong intends to purchase a US palm oil processing plant next year in order to further penetrate the US market, according to State reports.

- o Taiwan and Korea are likely to be two additional important growth markets for US agricultural inputs as they expand their agriculture sectors. [redacted] 25X1

[redacted] 25X1

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Added prosperity from farm sector growth in some LDCs may also generate raw commodity sales from the United States. In Brazil, despite expectations of a record 5 million ton wheat crop, 1987 wheat imports are estimated at a near-record 4 million tons--nearly 1.5 million of which will likely come from the United States--largely because of increased demand in the wake of consumer price freezes and relaxation of wage controls. More generally, if glutted agricultural export markets persist, more LDCs--following the lead of the versatile, broader-based economies of Brazil, Malaysia, and Thailand--will probably attempt to export higher value-added commodity-based consumer goods such as shoes and textiles, which in some cases could create new US opportunities for equipment sales and increased investment. 25X1

The growing strength of LDC agricultural exporters may also support some US objectives in the upcoming Uruguay Round of GATT negotiations. The Cairns group of 14 LDC and developed-country agricultural exporters--led by Australia and including several of the new agricultural competitors such as Thailand, Malaysia, and Brazil--will side with the United States in pushing for EC agricultural reforms. They will primarily be looking for a reduction of agricultural subsidies and for freer access for their burgeoning exports. 25X1

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On the negative side, the stronger position of LDC agricultural exporters poses a range of problems for the United States. Most important, as we noted in our earlier research paper, an already embattled US farm sector will face intense competition from LDCs for shrinking market shares (see Figure 1). In

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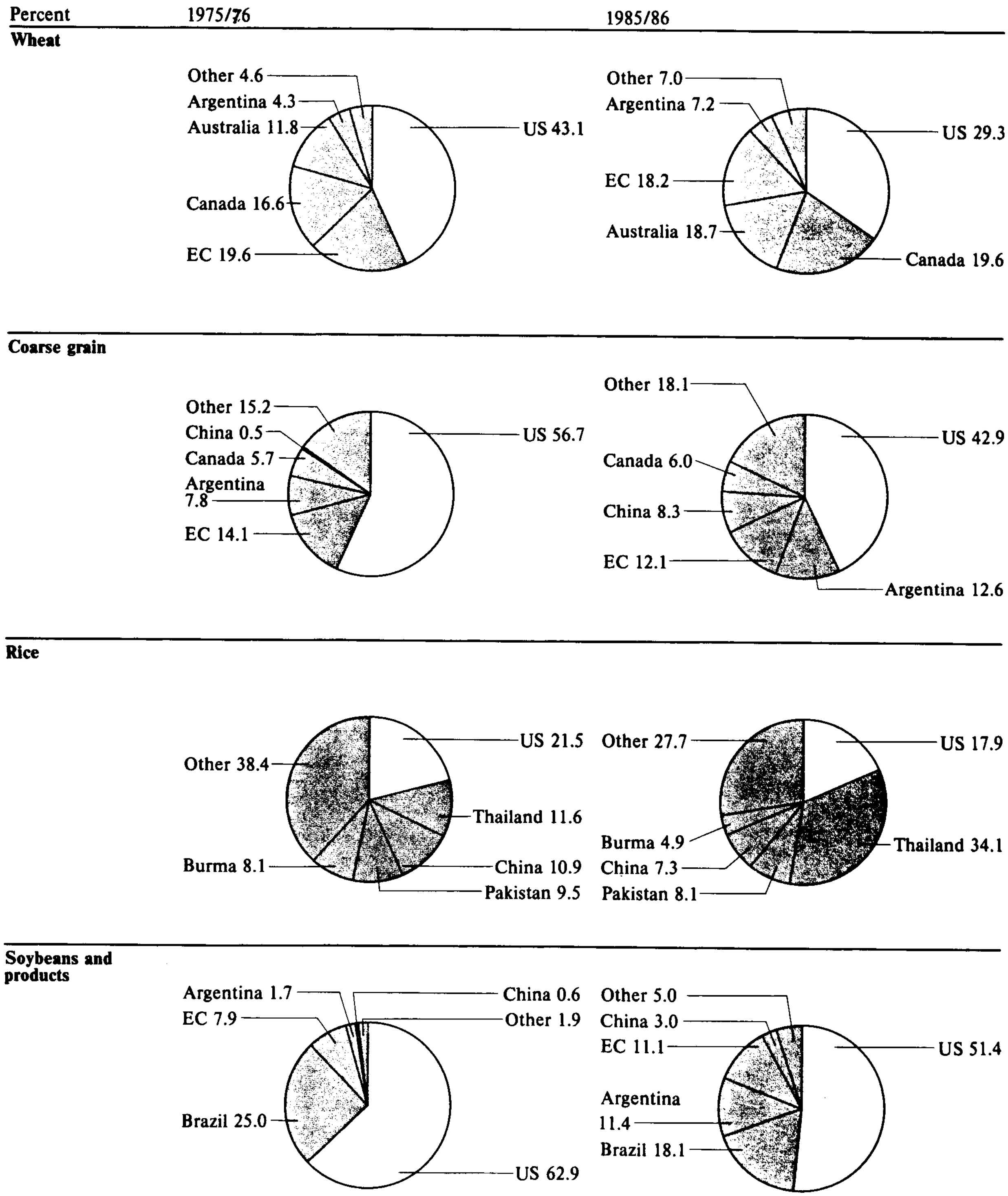
Figure 1

Export Market Share in Selected Commodities



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addition, expanding exports are likely to exacerbate already-strong trade tensions among LDCs that are US allies. Existing US bilateral trade disputes will become more contentious as the agriculture arena becomes crowded with players and burdened with surpluses. [redacted] 25X1

Moreover, as LDC agricultural exporters continue to increase their share of world markets, the United States will bear the rapidly escalating cost of maintaining the US farm economy at its current size. Most notably, because of the low production costs and natural competitive advantages enjoyed by Brazil and Argentina, lower US export prices will be needed before South American farmers will scale-back their production and exports of grain and oilseeds. [redacted] 25X1

As the new agricultural competitors expand farm production for self-sufficiency and export earnings, there will be increasing instability in commodity markets and resulting opportunities for Soviet manipulation. For example, Moscow--one of the world's largest commodity importers--may become more sophisticated in using grain, sugar, and other commodity purchases from debt-strapped LDCs such as Argentina to strengthen economic and political ties with these countries. Moreover, as the markets become increasingly glutted, the resulting lower prices will reduce Moscow's cost of exercising economic leverage for political purposes. [redacted] 25X1

[redacted] 25X1