

California's agricultural trade environment and prospects: A case for reform

1. Introduction

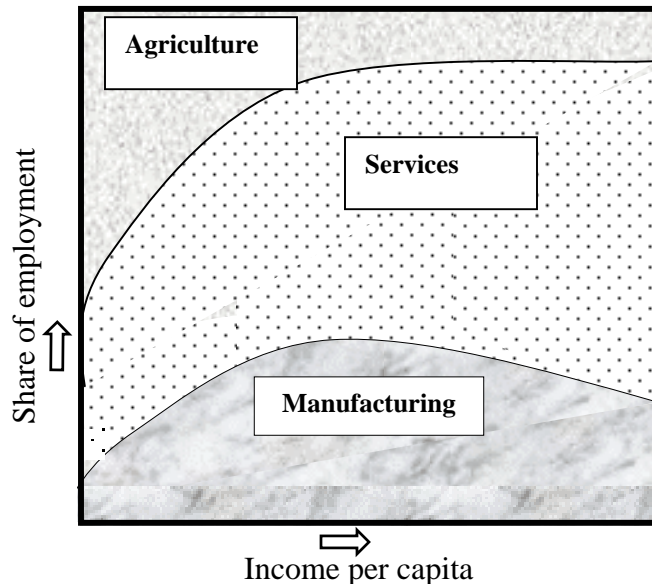
This issues paper describes California's agricultural trade environment and prospects. We summarize the rationale for international trade, briefly discuss the pros and cons of globalization, and discuss what it means for California agriculture to be "competitive" in an increasingly globalized marketplace. We review the importance of the state's key agricultural trading partners, including the role of China as both a market and a competitor.

Globalization describes the phenomenon of greater integration of international markets, including more cross-border movement of goods, services, and factors of production (such as capital, technology and labor). Classical economic theory predicts benefits to economies as a whole from integration of markets. The benefits arise because factors of production like labor and capital will be allocated more efficiently, across international borders as appropriate, and consumers will be given access to a wider variety of products at lower prices. Put another way, trade allows a region to shift its pattern of production so that it can produce more with the same endowment of resources—just like technological change, which allows a country to do more with less. Historical examples of strong economic growth largely bear out economists' predictions; production for international markets rather than the domestic market alone has led to rising average incomes. At the same time however, average gains mask the fact that there are both winners and losers within countries pursuing freer trade.

Globalization facilitates structural change within economies. However, the declining share of agriculture in the economy of California, the U.S., or other developed regions, is not a result of globalization alone. Well before the recent period of globalization, economists had pointed out two stylized facts that characterize the process of economic development; as incomes grow the relative importance of the agricultural sector falls and the importance of the services sector rises, as measured by their share of total employment. This process is often represented graphically; see Figure 1. Increased international trade may facilitate this structural transformation of an economy but many other factors contribute to this process, such as increasing average skill levels among workers and a rising capital stock relative to the supply of labor.

This issues paper was prepared by Colin A. Carter, Professor and Alix Peterson Zwane, Extension Specialist, University of California, as the basis for seminar discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Figure 1: The economic structural transformation process of a typical economy



This background is important to understanding California's agricultural trading environment, a sector that stands at a crossroad. While many barriers to trade in manufactures have fallen in the post-WWII period, this has not happened in agriculture. So agriculture has been relatively exempt from globalization's challenges. Agricultural input and output markets are still not well integrated across nations because many national governments continue to intervene in agricultural markets through subsidies, trade barriers, antidumping tariffs, state-trading and the like. If there were a successful political breakthrough in global agricultural policy reform, as currently under discussion at the World Trade Organization (WTO), then agriculture would become a more significant participant in globalization.

Some have argued that California's agricultural future is bleak because of globalization. They even go so far as to claim that without protection California agriculture will go out of business, because it cannot compete with developing countries. This view is largely based on the observation that agriculture is becoming less important in the state's economy and the belief that low wage rates and weak domestic regulations in developing countries will make California growers' costs relatively too high to successfully compete internationally.

One argument that we present in this issues paper is that neither low wage rates nor weak domestic regulations in developing countries mean an end to California agriculture. The fact that California agriculture continues to survive despite trade barriers in foreign markets underscores the fact that California agriculture remains efficient and competitive.¹ Productivity growth in California agriculture has been relatively high, holding costs down. California producers reduce the unit costs of production by substituting capital and technology for labor. From the early 1960s to the early 1990s California agriculture

¹ See McCalla and Johnston for a forward-looking view of the prospects facing California agriculture and an excellent discussion of the booms and busts that California agriculture has experienced.

productivity grew at about 1.8 percent per year, faster than for most of agriculture in the Midwest (Ball et. al.), and faster than most of U.S. manufacturing.

Several other trends also work in favor of California agriculture. There is a continuing shift in global food demand towards high-value differentiated products like those produced in California. Economies of scale and “spillovers” in California agriculture, which are not as important in other regions of the world that produce specialty crops, help keep California’s production costs low. The state has a dependable climate, cutting-edge technology, advanced human capital, productive labor, and world-class marketing networks, institutions, and infrastructure. Products that use these factors and originate in California are likely to compete successfully in an increasingly globalized marketplace. For example, the U.S. (led by California) is the largest exporter of horticultural products in the world, despite their generally labor-intensive nature. Furthermore, California has one of the fastest growing populations in the developed world, so local demand for food will continue to rise.

Despite these trends, not all producers of all crops currently grown in California will benefit from increasing globalization. The cost of production for specific agricultural products may indeed be higher in California than in foreign countries. However, this information alone gives little guidance as to the competitiveness of California’s agricultural sector. There are several reasons for this. First, comparing the cost of garlic production in California to the cost of garlic production in China, for example, obscures the point that today’s garlic growers need not grow garlic tomorrow. A structural transformation within the sector, towards products that capitalize on the state’s strengths, will allow California agriculture to most effectively meet the challenges and opportunities of globalization. Second, marketing costs, including transportation, are often a high share of total delivered costs. This makes foreign suppliers much less competitive during California’s production season for many fresh commodities. Indeed, even for many crops with a high import share, most of the imports enter off-season and the advantage of other countries is not cost-related but rather is seasonal. California firms can and do exploit the state’s climatic advantages by shifting fruit and vegetable production towards more fresh rather than processed products. More generally, increased trade exposes producers to more competition; the most efficient and productive growers and firms will do the best.

2. California Agriculture’s Trading Environment

California’s agricultural trade is characterized by: (1) a large volume of exports relative to production, (2) a diversity in exports that matches a varied agricultural production, (3) significant sales to rich-country markets, and high-income consumers, despite trade barriers in these markets, and (4) new competition for access to these markets from Mexico, China, and other temperate-zone emerging food exporters.

Compared to commodity growers in other states, and with some notable exceptions, California agriculture competes largely on its own merits in a complex and dynamic environment; but managing foreign competition and relatively closed markets remains a challenge. California agricultural producers rely on foreign markets for a significant portion of their revenues and export relatively more than producers in other states. According to the

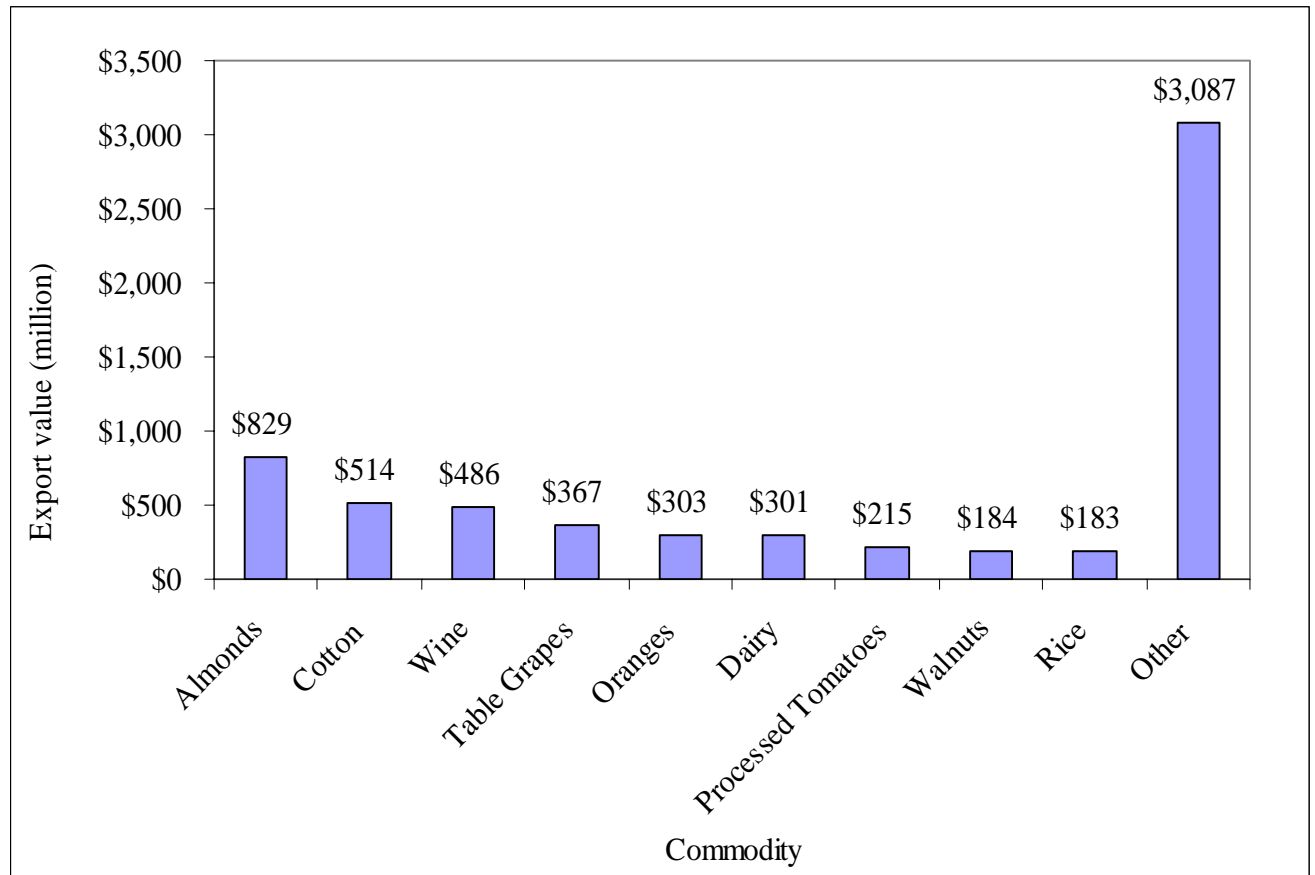
UC Agricultural Issues Center (AIC), the value of California agricultural exports totaled about \$6.5 billion in 2002, or about 25 percent of the value of agricultural commodities produced in California. While California accounts for 12 percent of national farm cash receipts, it accounts for an estimated 15 percent of total U.S. agricultural export revenue, despite the high population in the state.

California is unique among U.S. states in that it exports a wide variety of high-value specialty crops. The top six food product exports from California in 2002 (and for most recent years) were almonds, cotton, wine, table grapes, oranges, and dairy. Of any other state in the U.S., Florida's agriculture is perhaps most similar to California's. While the value of agricultural production in Florida is about 25 percent of that in California, Florida's agriculture is quite diversified and the state produces fruits, vegetables, and dairy products. However, with the exception of grapefruit, Florida is not as dependent on foreign markets as California is; many of its fruits and vegetables are sold domestically.

Figure 2 highlights the diversity of California's exports. The top five products account for less than 40 percent of California's agricultural exports by value. According to UC AIC statistics, fruit exports comprise 24 percent of the state's agricultural exports; followed by field crops (16 percent), tree nuts (18 percent), vegetables (8 percent), animal products (8 percent) and wine (8 percent).

California's exports are destined for a diverse group of relatively high-income countries, and, to a lesser extent, to high-income consumers in emerging markets. It is estimated that about 40 percent of California agricultural exports are destined for Asia, 21 percent to the EU, and 29 percent to North America. The share of California food exports destined for the relatively wealthy EU market is nearly double the same ratio for U.S. agricultural exports as a whole. The major foreign markets for almonds and wine are in Europe, while significant markets for the other top commodities are in Canada, Mexico, and Asia. Penetration of these desirable markets is all the more impressive because these countries remain quite protectionist with respect to agriculture, as discussed below.

The fortunes of California's commodities in external markets have been mixed in recent years. While the total nominal value of California's agricultural exports has declined by about 5 percent since 1995, this figure masks widely divergent trends across commodities so no general conclusions can be drawn. For example, almonds and wine exports have fared somewhat better than is the case for processing tomatoes and raisins. In the last decade, the nominal value of total U.S. agricultural exports grew by about 30 percent. Exports of some commodities important to California grew more rapidly and some less rapidly than the national average. Over this time period, U.S. dairy exports increased by 136 percent and wine exports increased by 150 percent, for example.

Figure 2: California's Agricultural Exports, 2002

Source: UC Agricultural Issues Center (<http://aic.ucdavis.edu>).

Note: Total agricultural export value for California is \$6.5 billion.

California's mixed export fortunes are partly the result of barriers to agricultural trade.² In general, there is growing per-capita demand in developed countries for fresh fruits and vegetables. Yet the share of fruit and vegetable trade in total world trade has been stagnant. This phenomenon critically affects California agriculture and it likely reflects the high level of protectionism around the world for these food categories, as well as intrinsic characteristics of perishability for fresh fruits and vegetables. Two-tiered tariffs known as tariff-rate quotas (TRQs) are commonly used to restrict imports of fruits and vegetables. Worldwide, there are more than 350 TRQs placed on trade in fruits and vegetables and more than 25 percent of all agricultural TRQs are concentrated in the fruit and vegetable trade.

Important markets for California agriculture remain protected. For example, in spite of the Canada-United States Free Trade Agreement (CUSTA) signed in 1989 and the North

² Exchange rate fluctuations, driven by many factors other than trade policy, can also affect the competitiveness of exports. When the U.S. dollar is "strong" American exporters find their goods less competitive in foreign markets and when the dollar is "weak" they find their products to be more competitive in these markets. The U.S. dollar rose by about 40 percent from 1995 to 2002, reducing the competitiveness of California agriculture during this period. More recently, the dollar has begun to fall against most major currencies.

American Free Trade Agreement (NAFTA) signed in 1994, Canada uses non-tariff barriers such as licenses to restrict imports of bulk produce, fresh fruits, vegetables, and wine. Canadian regulations on fresh fruit and vegetable imports prohibit consignment sales of fresh fruit and vegetables without a prearranged buyer. In a similar fashion, Japan continues to restrict imports of horticultural products, livestock products, and processed foods, all of which are important exports for California.

California must compete in third markets with products that receive export subsidies. According to the WTO, Canada's supply management system for dairy provides implicit export subsidies for these products. California's second most important market, the European Union (EU), offers export subsidies on beef, cheese, other dairy products, and processed fruit, in competition with California. It also provides generous production subsidies on horticultural products such as tomatoes, grapes, peaches and lemons. These policies reduce prices in third markets.

As an exporter of high-value food commodities, California must contend with import tariffs that are generally higher on processed agricultural products than on the underlying primary commodities. This tariff wedge between a processed commodity (e.g., processed fruit) and its corresponding primary commodity (e.g., fresh fruit) is referred to as tariff escalation, and this is a significant obstacle to California exports. Tariff escalation produces a trade bias against processed agricultural products and value-added products. There is general evidence of tariff escalation in developed countries (such as Australia, Canada, the EU, and New Zealand), especially for fruits, vegetables, and nuts.

Barriers to trade that California growers face go beyond tariffs and quotas, as non-tariff barriers (NTBs) are of growing importance. These include sanitary and phytosanitary measures (SPS)—for example, Japan's testing requirements for imported apples, cherries, nectarines and walnuts—found to be “without scientific merit” by the WTO. Food safety is also an emerging issue, because a series of food scares (e.g., BSE in the UK, Japan, Canada, and now the US) has resulted in higher consumer awareness of food quality. However, non-scientific food safety concerns are also commonly used as hidden protectionism in many markets. Reducing NTBs abroad may be important for California growers because they are likely to receive less SPS style protection at home in coming years. Foreign producers are organizing to combat U.S. SPS barriers, which they view as merely protectionist and lacking in scientific merit.

There is an upward trend globally in the use of antidumping (AD) and countervailing duty (CVD) laws, another NTB. Developing countries have criticized the use of AD and CVD laws in developed countries. For instance, Brazil refused to fully engage itself in discussions on the Free Trade Area of the Americas (FTAA) because of the continued application of U.S. AD duties on agricultural products. In 2002, Chile complained about the filing of AD cases on exports of raspberries and spring table grapes to the United States. Honey producers in the United States have also received AD protection from competition from Argentina and China as well as CVD protection from Argentina. These legal cases undermine the gains from more liberalized trade through reduction of traditional tariffs and quotas.

The European Union's (EU) mandatory genetically modified (GM) food labeling law is a good example of a non-scientific barrier facing U.S. agriculture. The significance of the EU's opposition to GM foods will soon become important for California agriculture because the state of California has a huge stake in biotechnology. A recent study (by Gianessi et. al.) concluded "California is the state with the highest potential economic impact associated with adoption of GM crops." Introduction of herbicide, insect and disease resistant crops such as rice, grapes, alfalfa, tomatoes and lettuce would mean California would account for over 40 percent of the potential impact of reduced pesticide use in the nation

California also faces competition in the domestic market and in third markets from China, Mexico, and other countries that may have lower labor costs than California. Concerns about competitiveness lay at the root of the debate over the effects of liberalized trade with Mexico and China (and other labor-abundant countries) precisely because the production of fruits and vegetables, nuts, and various horticultural crops can be very labor intensive with labor costs ranging from 20 to 50 percent of total production costs.

It is easy to overstate the wage advantage enjoyed by developing countries. Low wage rates generally reflect relatively low labor productivity and often do not translate into significantly lower per unit labor costs due to less efficient use of labor. Low wage rates can also be accompanied by relatively high costs for other inputs in the production process. Developing country producers often contend with high transport costs because of poor infrastructure and high capital costs because of undeveloped financial sectors.

China, Mexico, and other developing countries also have less restrictive domestic environmental regulation than California. Complying with California regulations may raise producers' costs above their developing country competitors'. As in the case of wage differentials however, the competitive edge actually gained from looser environmental regulations can be overstated. To access desirable markets, developing county exporters often aim to meet the strict international standards for food safety, labor, and the environment being set by large global retail and foodservice buyers. For example, just as most U.S. fresh fruit and vegetable producers are rapidly becoming certified by third party food safety certifiers, most foreign fresh fruit and vegetable producers shipping to the U.S. market are engaging the same U.S. food safety certifying firms.

The NAFTA experience is instructive for understanding the effects of more open trade. Mexico has access to rapid overland transport to the U.S. market, as opposed to more expensive and lengthy marine transport for offshore producers, and Mexico grows agricultural products very similar to those grown in California. However, NAFTA has not resulted in a massive shift of agricultural production to Mexico. The crops that are shifting to Mexico are mainly those that require bunching at harvest, such as green onions, radishes and asparagus, and these are relatively small volume crops. Even fresh strawberry production, the most labor-intensive of all and one of the most expensive to grow, has remained in California and in fact the state's strawberry acreage has grown by 20 percent in the past five years. California exports to Mexico on the other hand are gradually expanding to meet the demands of a growing middle class for high quality food products.

In response to both real and exaggerated declines in export earnings and increased production of fruits and vegetables by other countries, California growers have sometimes reacted by lobbying for increased protection. Take for example the recent “tomato wars,” in which American greenhouse tomato producers accused the Canadians of “dumping” tomatoes in the U.S. market. In October 2001, the U.S. government ruled that Canadian growers were dumping greenhouse tomatoes into the U.S. at prices below the cost of production. As a result of this finding, Canadian sales into the United States were assessed an average tariff of 32 percent. Several weeks later, the legal tables were turned as the Canadian government initiated an anti-dumping (AD) investigation against the U.S. fresh tomato industry. By July 2002, both cases were resolved with identical rulings of no material injury.

The potential for tit-for-tat escalating tariffs and counter-tariffs that can result from appeals to AD rules may seriously limit their benefits to California agriculture as a whole, even if small groups can use them to obtain short-run relief from competition. Pursuing AD claims against developing countries may be especially risky. Developing countries have a growing willingness to pursue dumping suits against U.S. producers. For instance, China is emerging as a significant user of AD cases. Adjudication of cases in developing countries, where transparency and accountability may be low, can be challenging for U.S. producers.

While decrying such policies abroad, California growers have supported non-tariff trade barriers (NTBs) in an attempt to limit foreign access to the domestic market. For example, in the 2002 Farm Bill, Congress mandated retail country-of-origin labeling (COOL) for fresh and frozen food commodities such as meats, fish, fruits and vegetables, and peanuts. The California Farm Bureau Federation (CFBF) and the Western Growers Association endorsed this regulation. These groups generally argued that consumers want labeling, and that the legislation is a valuable “marketing tool.” Despite these claims, the benefits of COOL are unlikely to outweigh the costs of compliance. The fact that producers and most retailers have not found it profitable to provide COOL to customers voluntarily is strong evidence that consumer willingness to pay for this information does not outweigh the cost of providing it. If the benefits outweighed the costs, profit-maximizing firms would have already made the best of this opportunity.³

COOL acts as a NTB just like mandatory genetically modified food (GM) labeling in the EU. Ironically, the U.S. government has strongly opposed mandatory GM labeling, and for good reason. In practice, GM labeling has not given EU consumers greater choice, because food processors in Europe have recombined ingredients away from GM crops to avoid labeling.

Another possible NTB that may impact California is Geographical Indicators (GIs); the EU is attempting to restrict the naming of food products to their original region of manufacture. For example, most cheeses (such as Feta, Mozzarella or Parmesan) and many wines (such as Chablis and Beaujolais) have names with European origin. The EU wants to prevent producers of food and wine from calling products by regional names unless they were

³ Implementation of COOL has recently been postponed for two years as more agricultural and retail groups question the net benefits of the regulation.

produced in those regions. The United States and many other countries reject the EU proposal on GIs, and this issue will be debated in the Doha round of WTO negotiations.

Besides NTBs, fruit and vegetable growers have also lobbied for increased federal marketing support. The Market Access Program (MAP) and the Foreign Market Development Program (FMD) subsidize the cost of market development activities overseas. A new program called Technical Assistance for Specialty Crops Program (TASC) is intended to fund projects that address technical barriers to the export of specialty crops. Among these programs, the most important to California producers is the MAP, which received increased funding in the 2002 Farm Bill.

Whether export promotion programs like MAP and FMD actually benefit California agriculture remains unclear. A 1997 study of agricultural export programs sponsored by the U.S. General Accounting Office concludes that agricultural export programs “reallocate production, employment, and income between sectors” rather than increasing total economic activity. This suggests that programs like the MAP are not cost-effective uses of public funds. If the benefits of marketing efforts exceed their costs, then firms should find it profitable to undertake these efforts without government assistance.

Perhaps the most problematic element of MAP, and potentially of the TASC, is that even if it successfully increases exports of assisted commodities to targeted markets, there is evidence that this is often to the detriment of unassisted products. For example, proponents of MAP point to a projected increase of \$5.30 over 40 years in the value of walnut exports to Japan for every \$1.00 spent on walnut promotion. However, another study found that while every dollar spent on walnut promotion increased walnut exports by \$1.42, it actually reduced the exports of other horticultural products by \$3.57 per dollar spent, resulting in a net reduction in U.S. agricultural exports for every dollar spent by \$2.15.

Dairy, cotton, and rice farmers in California benefit from significant income transfers as a result of public policy. While California farmers often claim that they receive much less support than commodity growers in the Midwest, which is correct, they also receive almost four times as much support on average as growers in more open economies like Australia. This is true even when payments through U.S. environmental programs are excluded.

California agriculture does not have a consensus position regarding trade liberalization in agriculture. Calls for additional support or protection for California agriculture have not been unaccompanied by calls for more open markets. The CFBF has stated that additional government support for marketing efforts is critical, but has also agreed that export subsidies for dairy and poultry should be phased out entirely as part of on-going WTO negotiations and has called for wide-ranging reform. Not all growers whole-heartedly support this position however, as the number of AD cases and the popularity of COOL suggest.

3. A Key Competitor: China

In addition to serving as a growing market for California food products, China is also a competitor in third markets. Many growers in California ask how they can possibly compete with China's farmers—especially in horticultural products. China can produce a wide variety of horticultural products year round. The fear on this side of the Pacific is that China can produce walnuts, garlic, strawberries and honey for less because of its low labor costs. China has a large rural labor force, with about 250 million farm workers, earning a typical daily wage of \$2. Ironically, at the same time, farmers in China are concerned that they cannot compete in the new globalized market. They feel that they lack the human capital, technology, investment and infrastructure, to produce high quality food products.

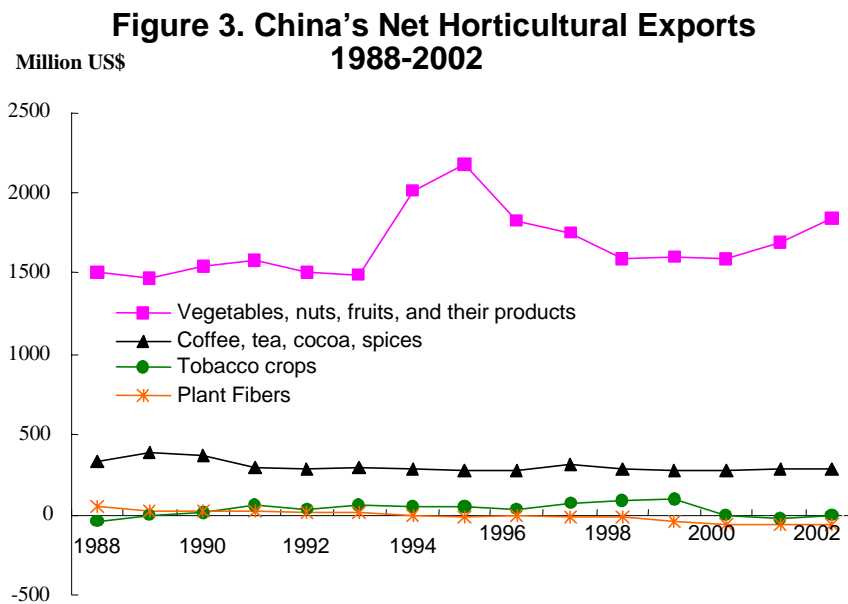
China is the world's largest producer and consumer of horticultural products, and horticulture is a growing component of China's agriculture. From 1980 to 1990, the vegetable sown area expanded from 7.9 to 15.6 million acres, and reached 48.4 million acres by 2002. This is more than a six-fold increase in twenty years. According to the most recent land use data available, in 2001, the share of vegetable sown area in the total agricultural planted area was 10.5 percent, and the share of orchards was 5.8 percent. Production of fresh vegetables grew 82 percent in volume between 1995 and 2002, while fruit production grew 54 percent. The vast majority of this production growth went to satisfy expanding internal food demand.

The importance of horticultural products as a share of China's agricultural trade has also increased, and its net exports of horticultural products totaled \$3.7 billion in 2002. China's horticultural exports rose 47 percent during the 1990s (Donovan and Krissoff, 2001), and fruits and vegetables as a share of agricultural exports was 30.6 percent in 2001. On the other side of the ledger, China's horticultural imports increased in value at an annual rate of about 5 percent in the period 1988 to 2002, rising from \$0.3 billion in 1988 to \$1.1 billion in 2002. The rapid increase in imports was partly due to a growing demand for high quality produce (e.g., broccoli, navel oranges and grapefruit) and partly attributed to the relaxation of trade barriers in the 1990s. Fruit and vegetable imports accounted for 7.5 percent of China's total agricultural imports in 2001, up from 1.7 percent in 1980

Despite these gains, China remains a mid-size player in the world horticultural market. China's fruit and vegetable exports (imports) account for about 5.7 (1.6) percent of total world trade in fruits and vegetables. Trends in China's horticultural trade are presented in Figure 3. Among the four categories shown, the group comprised of vegetables, nuts, fruits and their processed products dominates China's horticultural trade. Its share of China's horticultural exports was 84 percent in 2002, while its import share was 67 percent.

As the data presented here suggests, China is becoming increasingly integrated in global markets. With liberalization, trade patterns will become more consistent with China's resource endowment. Since China's horticultural trade patterns have not changed that much, we anticipate significant trade impacts associated with WTO accession. In 2001, China rejoined the WTO after fifteen years of negotiations. In compliance with WTO rules, China agreed to undertake a series of important measures to liberalize its trading regime and

committed to offer a more predictable environment for trade and foreign investment. WTO membership will possibly facilitate foreign direct investment, improve marketing channels, and help China improve product quality to realize its production potential. On the other hand, WTO membership will significantly improve market access opportunities for exporting countries trying to sell horticultural products into China. Tariff levels for major horticultural products will be reduced dramatically. For instance, in 2004 the tariff on oranges drops from the pre-WTO level of 40 percent to 12 percent. In addition, China has agreed to the WTO's SPS rules and this will reduce China's ability to use non-scientific technical trade barriers. Moreover, the licensing and distribution system is being quickly liberalized and exporters can now do business with private traders in China more freely. All these factors lead some exporters to view China as a very attractive horticultural market, given the expected growth in demand for vegetables and fruits stemming from urbanization and rising income levels.



Source: China's Customs Statistics.

4. What's at stake for California at the WTO?

Not all California farmers will gain from increased trade liberalization. Ending government support for agriculture and lowering trade barriers will benefit some more than others. On the whole however, California producers sell high-value competitive products, and their major markets, especially Japan and the EU, remain protected. Coordinated liberalization that affords California increased access to these markets, even if at the expense of increased competition from China and Mexico, is an important opportunity.

Multilateral trade liberalization is preferable to new barriers for California agriculture to hide behind, whether these barriers are explicit or implicit. As the "tomato wars" illustrate, anti-dumping tariffs can be easily met in a retaliatory fashion. And implicit barriers to trade like COOL may bring little or no benefit to the agricultural sector when costs imposed throughout

the marketing chain are considered. Government funded marketing programs do little for the agricultural sector as a whole, and they attract negative publicity as a form of “corporate welfare.” Besides distorting production and increasing costs for domestic consumers, explicit production subsidies cause even worse press; the aid organization OxFam recently released a policy paper stating that U.S. cotton subsidies are destroying the livelihoods of poor African farmers.

California growers’ potential gains from multilateral liberalization put them in a different position than some other U.S. farmers. Commodity growers in the Midwest face the loss of price and income support under aggressive liberalization, and growers in Florida might lose from freer trade because they are not so dependent on foreign markets. The position of the Florida growers has a negative spillover impact on California, which is unfortunate because California growers have a great deal to gain from breaking down foreign trade barriers.

Coordinated liberalization does expose California growers to new competition from Mexico and China. Market integration may also lead to new food safety concerns, as the recent BSE scare in the U.S./Canada illustrates. But higher incomes in these countries and other large middle-income countries should also translate into increased demand for high-value fresh produce and wine, especially if tariff escalation is reduced. Product differentiation is an important competitive strategy in a global marketplace that California can effectively use. California has a reputation as a high quality producer and increasingly, as a producer of value-added agricultural and food products. As the trend toward adding value continues to unfold, agricultural goods will less and less be homogenous. There are new opportunities for business in emerging markets as well as competitive challenges.

Bilateral or regional trading agreements are less beneficial to California agriculture than multilateral liberalization for several reasons. First, it not realistic to expect significant trading partners such as the EU or Japan to unilaterally remove their barriers to market access. The U.S. purchases a significant amount of food from the EU in particular; thus the EU will reasonably expect reciprocal liberalization of the U.S. market if it makes the politically difficult effort to reform its agricultural policy. Agreements with more minor trading partners (e.g., Australia and Chile) will bring few substantive economic gains. Second, bilateral agreements with agricultural exporters will likely require that domestic agricultural policy reform be confronted. For example, Brazil wants FTAA negotiations to include farm subsidies and antidumping measures, but the U.S. administration says these issues will only be negotiated at the WTO. Brazil has also challenged U.S. cotton subsidies, and is concerned about high U.S. import tariffs on orange juice, sugar, tobacco, and ethanol. It is true that many other Latin American countries are supportive of the FTAA, outside of the WTO, partly because the value of agricultural trade is expected to rise significantly.⁴ Significant gains for the U.S. are partly predicated on access to the large Brazilian market

⁴ The value of agricultural trade among the U.S., Canada, and Mexico has increased by 120 percent since signing the NAFTA agreement. For further information, see Thomas L. Vollrath “North American Agricultural Market Integration and Its Impact on the Food and Fiber System” USDA, ERS Agriculture Information Bulletin No. AIB784, September 2003, Washington DC.

however, and in the case of an agreement with Chile or Australia, this trade may displace some production currently undertaken in California.

Rather than growers in the Midwest or Florida, California agriculture's natural allies at the WTO may be the Cairns Group countries, a coalition of developed and developing countries that provide little domestic support for agriculture and who expect to benefit from trade liberalization. The Cairns Group has not only called for elimination of farm subsidies, but has also denounced the U.S. 2002 Farm Bill as a serious step back from reform. This issue has also been taken up by a new coalition of developing countries (the G20), and their opposition to rich country subsidies led them to pull out of the WTO's Ministerial Conference in Cancun Mexico in September 2003.

To conclude, California's agricultural trading environment holds both new challenges and new opportunities. Established markets in developed countries continue to erect barriers to California's specialty crops, and the developing Chinese market holds uncertain benefits and certain new competition. Lowering barriers to agricultural trade in the protected EU and Japanese markets will undoubtedly benefit California, even if it comes at the cost of reduced subsidies and support at home.

5. Issues for discussion

Increasing international trade liberalization creates both winners and losers.

- In January 2004 Robert Zoellick, US trade representative, wrote a letter to WTO members, urging a revival of WTO trade negotiations. Is the U.S. proposal to eliminate agricultural trade-distorting subsidies and barriers to market access meaningful, achievable, and desirable?
- Is the Zoellick proposal credible given the limited political support in the U.S. Congress for agricultural trade liberalization?
- Are the interests of consumers and poor countries adequately represented at trade negotiations?
- Geographical Indicators are designed to protect the reputation of regionally based high quality products. Is the EU proposal for an international register of GIs a good idea for California agriculture to make the most of its reputation for high-quality food products?

Responses to increasing international competition can take many forms. What are the benefits/costs of the following strategies for U.S. producers, consumers, and taxpayers?

- Tariff barriers and SPS regulations to protect the domestic market;
- Government supported marketing programs;
- Research and extension;
- Income transfers to farmers or production subsidies; and
- Strategic alliances or joint ventures among firms aimed at improving competitiveness.

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Notes

