Short-Term Outlook

Grains

The preliminary FAPRI baseline forecasts the 1998/99 average U.S. farm prices for wheat and corn to be $2.61 and $2.01 per bushel, respectively, which is significantly lower than in the past two years.

World wheat production in 1998/99 is projected to be 588 million metric tons (mmt) as compared to record 611 mmt in 1997/98. More recent U.S. Department of Agriculture (USDA) estimates are lower than FAPRI’s, with an additional 2.5 mmt reduction in world wheat production for 1998/99. Despite more than 20 mmt lower production than in 1997/98, prices for this year are projected to decline because of higher carryover stock from last year and weak import demand, particularly from the economically beleaguered Asian countries.

The situation for corn is somewhat different. Corn prices are down primarily due to higher world production and weaker import demand. World corn production is projected to be 597 mmt in 1998/99, approximately 19 mmt higher than last year. More importantly, all of this increased production has come from exporting countries such as the United States and China, putting more downward pressure on prices. The situation would have been much worse without the 6 mmt (or 30 percent) reduction in Argentina’s corn production relative to last year.

For 1999/00, FAPRI projects the average U.S. farm price for wheat and corn at $3.03 and $2.11 per bushel, respectively. Projected fewer acres planted and recovery in import demand from Asian countries are the primary factors for higher wheat prices next year. Similarly, corn prices are projected to be slightly higher next year mainly because of recovery in import demand and lower planted area. Recovery of corn prices next year depends heavily on the Chinese net trade position.

Rice prices, unlike other grains, have remained relatively strong for most the year. The 1998/99 Thai price for 100 percent grade B rice is projected to be $308 per mmt, slightly higher than last year’s price. Despite a projected 2.4 percent drop in world production, prices are projected to rise slightly because more than 20 percent of this decline is from Japan and South Korea, whose import levels are largely determined by General Agreement on Tariff and Trade (GATT) import access commitments. Most of the remaining production decline is expected from exporting countries such as China, India, Australia, and Vietnam, resulting in lesser impacts on world import demand.

Oilseeds

Preliminary projections from FAPRI’s 1999 baseline indicate a 16.4 percent decline in U.S. soybean prices, from $6.45 per bushel in 1997/98 to $5.36 per bushel this year. These prices are expected to decline further to $5.20 in 99/00 before starting an upward trend in 00/01. Soy meal prices are projected to decline by about 22 percent in 1998/99 from a year ago, while the overall decline in soy oil prices in the same period is expected to be around 2 percent. Most other oilseeds and products are expected to follow this pattern as well. U.S. soybean price harvested is projected to be almost 1 million acres higher in 1998/99 compared with a year ago, but it is projected to decline slightly in 1999/00.

During the past few months, soy oil demand has seen an unprecedented surge in reaction to relatively high palm prices due to a smaller Malaysian crop. The Oil World reports that demand rationing has been introduced for Malaysian palm oil as yields and production estimates were lowered further last month. This supply constraint and strong import demand European Union (EU) palm oil imports have been 40 percent higher this year, have kept the pressure on palm oil prices throughout this year.

While palm oil prices remain high and supplies are tight, many oil importers have been substituting palm oil imports with seed oils (mainly soy, rape, and sunflower) prompting near record crushings in the United States, Argentina, and Brazil (the Big 3). Exports of
these oils have surged by about 3.5 million tons in the current year. In addition, the oil demand from financially strained Asian regions is also beginning to show signs of improvement, thus maintaining the pressure on seed oil prices. Record crushings of oilseeds have also yielded a glut of meal supplies in the world markets exerting strong downward pressure on meal prices. On the other hand, lower meal prices are also expected to increase the overall demand by allowing substitution of lower-priced meals in place of higher-priced grains. This could ease the pressure on meal prices in the coming months.

Given this situation, the fluctuations in near-term prices of oilseeds and products will be mainly determined by several factors including:

- Weather conditions in the Southern hemisphere. Continued good moisture conditions combined with continued strong world demand for soybean oil should produce another good crop in this region next year. Argentina is also reporting a bumper sunflower crop, indicating the softening of sunflower and product prices in the coming months.
- Economic and political conditions in some of the severely affected Southeast Asian countries (e.g., Indonesia), as well as in Russia and Brazil.
- Meal import demand from large importers like the EU; and the possibility of further substitution between soybeans and soybean meal imports by China.

**Livestock**

World beef net imports are expected to register a modest increase of 21 thousand metric tons (tmt) in 1999 according to FAPRI’s November baseline. Next year Mexican net imports of beef are projected to be 79 tmt more than the 1998 level, and South Korean imports will grow 43 tmt. Nevertheless, South Korea’s imports only account for 60 percent of its minimum access volume (MAV) for beef. The weak economic conditions in Japan and Russia prompt declines in beef net imports that offset more than 80 percent of the increase in Mexico and South Korea. The reduction in Russian beef imports dampens the demand for EU beef exports, keeping the 1999 level at only 83 percent of the EU’s maximum subsidized exports allowed by the World Trade Organization (WTO). Since many of the major beef exporters are either at the bottom of their cattle cycle or early in the stock rebuilding phase, the modest increase in import demand causes the world price of beef to increase 6.87 percent in 1999.

World pork prices declined by 35.6 percent in 1998. This was caused by over production in many pork exporting countries at a time when import demand was shrinking. The world pork price is expected to recover slightly, increasing by 8.17 percent in 1999. Japan’s pork imports, which were adversely affected by the foot and mouth disease (FMD) outbreak in Taiwan in 1997 and the Asian crisis in 1998, are expected to rise a modest 25 tmt in 1999. The recovery in Japanese pork imports is aided by the substitution of pork for broiler meat following the highly publicized avian flu outbreak in neighboring Hong Kong. International pork purchases by Russia, Hong Kong, and South Korea are expected to decline a total of 17 tmt, negatively impacting exports from the EU, Canada, China, and Poland.

The world broiler price is expected to decline by 2.11 percent in 1999. Although import demand in China, Hong Kong, and South Korea will recover from the negative effects of the avian flu outbreak in 1999, economic difficulties in Russia prevent world broiler import demand from posting strong increases. On the supply side, the appreciation of currencies in EU countries and high domestic broiler prices in Thailand hurt the competitiveness of these countries in the international broiler market, causing their share of total broiler exports to slip slightly. U.S. broiler exports are expected to increase 15 tmt 1999, roughly maintaining the U.S. share of broiler total net trade at 59.5 percent.

**The Past, Present, and Future of Export Enhancement Program**

The Export Enhancement Program (EEP) was initiated under the Food Security Act of 1985. The purpose of this program is to offset the adverse effects on U.S. exports due to unfair trade practices or subsidies by competing exporters, particularly the European Union (EU), and also to support U.S. prices. This program allows exporters to sell U.S. products in targeted markets at prices below their costs by providing cash bonuses. Since its inception, EEP has played a major role in the export of many agricultural commodities such as wheat, malting barley, rice, feed grains, vegetable oils, eggs, frozen poultry, frozen pork, and dairy products. Figure 1 shows the distribution of EEP expenditures for wheat and other products for the period of 1985 to 1997 on a fiscal year basis. Among various commodities, wheat accounts for more than 80 percent of the value of all EEP-assisted sales. Until 1994, EEP was applied to an average of 50 to 70 percent of U.S. wheat exports.

The impact of EEP in terms of additionality and cost effectiveness has been analyzed in various studies. The results of these studies have varied widely, with additionality ranging from 5 to 70 percent. Similarly, the U.S. General Accounting Office, in summarizing the findings of past studies, reported that EEP is responsible for the 0.8 to 12 percent rise in U.S. wheat prices. Because it raises U.S. prices, EEP has also been suggested as the primary impetus for the increased Cana-
dian wheat exports into the United States in the early 1990s.

Under the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), the United States has agreed to reduce the value of expenditures on subsidized exports and to reduce the volume of subsidized expenditures relative to the 1986-90 base. In addition, the Federal Agriculture Improment and Reform (FAIR) Act of 1996 has further reduced EEP expenditures to below GATT commitments until 2002. But these quantity and value constraints on EEP subsidies have not been a factor, as the United States has not exported any wheat under EEP since July 1995. Tight world supplies caused the crop prices to be very high resulting in the disappearance of export subsidies by competing wheat exporters including United States and the EU. During this period, the EU even instituted an export tax to control the outflow of wheat. Larger supplies and somewhat static import demand have weakened crop prices in recent years. Since October 1996, the EU has started exporting wheat, with subsidies and the extent of subsidies rising much higher in recent months.

It has been more than two years since the EU began subsidizing wheat exports, but the United States has restrained itself from exporting wheat under the EEP. However, the situation under which the United States subsidized wheat exports in retaliation to subsidized exports by competing countries, particularly the EU, is not the same. In recent years, the EU has not been aggressive in the U.S. dominated market, which has enabled the United States not to initialize wheat exports under EEP. On the other hand, the EU has not been aggressive in the U.S. market because of the fear that its aggressiveness may result in retaliation from the United States in the form of subsidized exports.

In the future, the use of EEP subsidies for wheat will be closely tied to the U.S. market share in the world market. If the EU’s proposed Agenda 2000 is approved, it will definitely make the EU more competitive in the world market by enabling EU to export without subsidy, which otherwise would have been constrained by GATT limitations. In addition, eastward expansion of the EU to include Eastern and Central European countries will make it even a larger exporter of wheat. There is also a possibility that these changes may bring back the EEP as a weapon to regain some lost market shares.

The next round of the World Trade Organization (WTO) negotiations, which is scheduled to convene in 1999, will also play a significant role in the existence of EEP in the future. The United States has already indicated, in a presentation to trading partners in Geneva, Switzerland, that it favors outlawing export subsidies like its own EEP during the next round of WTO negotiations. Overall, it appears that there is very little support for the continuation of this program in the future.

1 Additionality is measured as the proportion of subsidized exports that would not have occurred in the absence of EEP programs.

China: A Wildcard Player in the World Grain Market

China is the largest producer of grain in the world, accounting for approximately 14 percent of world production. In terms of individual commodities, it is the largest producer of wheat and rice, and second largest producer of corn. Despite China’s status as the largest grain producer, its vast population, limited agricultural land, and rising livestock production have contributed to erratic behavior in world grain markets.

Historically, China has been self-sufficient in rice production, with small exports of rice in most years during the past two decades. The situation in wheat is somewhat different. Traditionally, China has been one of the largest importers of wheat. Rising livestock production has severely limited Chinese corn exports in the past five years. China had to import a small amount of corn in 1994/95 and 1995/96 to meet rising domestic consumption.

China’s sudden turnaround from large exporter of corn to importer in 1994/95, along with large wheat imports, led many researchers to believe that China was beginning to enter into a new era of grain trade. Consequently, China became a focus of attention for government policy and academic research, analyzing the balance of Chinese grain production and consumption. During 1995 and 1996, various research organizations including FAPRI, the U.S. Department of Agriculture (USDA), and the International Food Policy Research Institute (IFPRI) projected Chinese grain imports to reach 22 to 25 million metric tons (mmt) by 2005 and 40 to 45 mmt by 2020.

In past three years, China has proven everybody wrong by becoming a net exporter of corn. More importantly, its wheat imports have declined by more than 80 percent. Researchers have realized that Chinese livestock production has been over estimated by 20 to 30 percent because of double counting of animal slaughter and inflated output statistics reported by local officials (USDA’s Agricultural Outlook, November 1998). In addition to livestock production, researchers have also found that Chinese crop planted area is under estimated and yield over estimated. Thus, the reported yield is much higher than the actual yield, making Chinese yield growth potential higher than previously expected. In addition to inconsistency in the reported data, it is also extremely difficult to correctly forecast Chinese grain trade because of government interventions. The government makes all decisions on the
quantity of grain exports and imports, which is implemented by COFCO, a state-run organization.

Taking into account the above mentioned factors, FAPRI now projects China to be a small net exporter of rice for the next decade (Figure 2). Even with projected decline in rice area, China will be able meet the domestic demand in the face of declining urban per capita consumption.

In the case of wheat, China is projected to import an average of 1 to 2 mmt of wheat throughout the projection period, which is much smaller than its imports in last two decades (Figure 2). Chinese wheat imports are not projected to reach anywhere close to its traditional level because of flat per capita wheat consumption. Unlike wheat and rice, the projection for corn involves a lot more uncertainties because of government policies and the use of corn as livestock feed.

Government policies dictating self-sufficiency in corn or meat will largely determine China’s position in the world corn market. The current policy is aimed at achieving self-sufficiency both in corn and meat. Within crop sector, policy makers are tilting toward achieving self-sufficiency in grain rather than oilseeds. In addition to government policies, accuracy in corn consumption projection involves getting a handle on the future of the livestock industry. Structural change in livestock production, technological improvements in feed efficiency, and other factors lead FAPRI to project that China will be a small net exporter of corn for the next few years. It will eventually become a net importer early in the next century. By 2008/09, China is projected to import 3.3 mmt of corn (Figure 2).

Overall, Chinese net imports of grain are projected to be around 8 mmt by 2008/09. This number is significantly smaller than earlier FAPRI projections. However, this number still depends on the future direction of Chinese policy, which has been instrumental in dictating the country’s grain situation for last two decades.

Chinese grain production boomed in the 1980s when the communal system was abandoned and farmers were given somewhat greater discretion under the “household responsibility system.” This policy was abandoned in the early 1990s as production exceeded consumption. In 1994, a poor harvest and warnings from outsiders that China would not be able to feed itself led policymakers to implement the “Governor Responsibility System,” and the central government declared its intention to reassert control over the majority of commercial grain stocks. Changes in policy and favorable weather has turned China from a large net importer to a small net exporter of grain in the past three years.

These policy changes have led to huge losses for the government at an estimated $1.8 billion a month in 1997. This has forced the government into another round of grain policy reforms in 1998. The new policy, which was announced in last spring, is aimed at eliminating costly subsidies and reducing the losses incurred by the central government in managing the purchase, storage, and transportation of grains (Agricultural Outlook, December 1998). The State Administration for Grain Reserves (SAGR) issued new regulations specifying that grain bureaus must buy all grain farmers want to sell, and grain bureaus may not sell grain at a loss. Also, the government wants farmers with fixed quota prices to sell all of their marketable grains to state-owned grain bureaus.

The new grain reforms represent a step back from a market-oriented grain distribution system. The new pricing structure will result in a real transfer of income from urban consumers to farmers, which will stimulate the enthusiasm of farmers to plant more grain. On the other hand, the elimination or reduction of export subsidies may make Chinese grain, particularly corn, less competitive in the global markets.

1 Includes wheat, rice, corn, barley, and sorghum.