



# Managing Risk in a Dynamic World Economy

## Curriculum Guide

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### I. Goal and Objectives:

- A. Understand the key sources of risk related to the globalization of agriculture and operating in a dynamic world economy.
- B. Understand the relationship between agriculture and world trade.
- C. Understand why trade is important to southern agriculture.

### II. Description/Highlights

- A. Agriculture in the United States is becoming increasingly trade oriented and more sensitive to events and actions which occur beyond our own borders. Congress recently approved two important trade agreements, the North American Free Trade Agreement (NAFTA) and the Uruguay Round Agreements (URA) negotiated under the auspices of the General Agreement on Tariffs and Trade (GATT).
- B. The 1996 farm bill removed the government safety net for some crops, leading to more downside price risk. Economic and political turmoil occurred in the former USSR. China emerged as a major force in world trade, but some other Asian powerhouses faltered. Biotechnology offered early promise of new products and production methods. Industry structure changed, with major growth in vertical integration, coordination, and the formation of strategic alliances. These changes have major impacts on producers and have presented new opportunities for some and new challenges for others.
- C. The first source of risk is weather and natural disasters. Normal fluctuations in global weather patterns affect world production of farm products, which in turn affects the prices of these products. Livestock producers are affected directly through weather impacts on forage crops and indirectly through changes in feed ingredient availability and cost. Abnormal natural phenomena, such as El Nino, can also trigger natural disasters leading to unusual crop shortfalls, drought, and flood, all in an incredibly short period of time.
- D. Technology may also be a source of risk. Technology is embodied in farm operating inputs, such as seeds and pest control, and capital assets, such as machinery and buildings. Performance of new innovations is uncertain but, once established, may render current farm practices and assets obsolete. Early adopters of new technology

take more risks because it may not work or be profitable, but they earn greater rewards when it does. The laggards have more information available because of the activities of the early adopters, but the major benefits may have vanished.

- E. The attitudes and preferences of consumers, both in the United States and in other countries, directly affect the demand for farm products. Indirectly, these attitudes influence government policies and regulations, and represent additional global risk.
- F. Institutional and policy factors encompass a wide array of government policies and regulations, the legal framework of society and business, and industry structure and performance. Government policies are pervasive and include farm, trade, macroeconomic, and environmental policies. Many of these policies have trade impacts. These linkages are often complex, but the policies affect competitiveness by causing changes in exchange rates, domestic policies, and production costs. Health and safety policies and regulations affect production processes and costs. International institutions, such as the World Trade Organization (WTO) increasingly affect trade rules. Global financial institutions, such as the International Monetary Fund (IMF), have become important sources of stability in the world economy and world trade, thereby reducing some risks.
- G. U.S. agriculture has much to gain from expanded trade since many countries already have low duty access to the U.S. market, while U.S. access to foreign markets may be limited by high tariffs or quotas. The value of U.S. agricultural exports consistently exceeds the cost of imports. It has been estimated that a one dollar increase in exports generates a second dollar's worth of related economic activity and that one new job is created for each additional \$50,000 of exports. In 1996, the U.S. exported \$60.4 billion of agricultural products compared to \$33.6 billion of imports (Table 1).
- H. Most of the imports were classified as competitive, i.e., they competed with similar products produced in the U.S. Only \$8 billion of imports were products not produced in the U.S., such as coffee, bananas, cocoa, and spices.
- I. The health of southern agriculture is heavily dependent on regional specialty crops; commodities the region has an innate advantage in producing because of climatic conditions. Among the most important of these crops are cotton, tobacco, rice, peanuts, citrus and other fruits, certain vegetables, and sugar cane. For virtually all of these commodities, major trade problems and issues have arisen.
- J. The 1996 Farm Bill abandoned most income supports for program crops and this will allow market forces to set prices, including domestic and international supply and demand. Farmers' production decisions will be made in response to these market signals.
- K. A second reason for the South's high stake in world agricultural trade is that the South is a marginal production area for most of the major nationally important farm commodities such as wheat, corn, soybeans.
- L. Because of the South's unique position as a producer of regional specialty crops and a

high-cost producer of most of the major, nationally grown commodities, southern agriculture is especially sensitive to the impact of world events. In the past, there have been painful adjustments by the producers of many crops. The South stands to benefit from the recent expansion in beef, pork and poultry exports because of its national ranking in the production of meat these products.

### III. Potential Speakers

- A. Marketing Club Advisors
- B. Extension Economists
- C. Global Business Managers
- D. National or State Government Officials

### IV. Review Questions

- A. Identify the four major sources of global risk which producers are likely to face.  
(1) Weather and natural disasters, (2) Technology, (3) Attitudes and Preferences, and (4) Institutional and Policies.
- B. Why are exchange rates an important source of risk?  
Influence the prices of goods traded and the competitiveness of farm products.
- C. Explain two reasons why trade is important to agriculture in the South.  
(1) Important producer of regional specialty crops (vegetables and fruits) and (2) marginal producer of nationally important crops (corn, wheat, soybeans) making the South especially sensitive to the impacts of world events.
- D. What is one of the most important characteristics of US agricultural trade?  
US agriculture generates a trade surplus every year, making it easier for US consumers to purchase foreign goods such as petroleum, electronics, textiles, and foods.
- E. The majority of US agricultural imports are classified as: complementary or competitive? Why is this important to US producers? Imports in this category, such as some fresh vegetables, compete directly with US production, driving down prices and returns to producers.

### V. For More Details

International Trade Leaflet Series, Leaflets 1,6, and 10 located at:<http://www.ipt.com/intlagmktg/mktinfo/leafindx.htm>



## ! Sources of Global Risk

- ☞ Weather and natural disaster
- ☞ Technology
- ☞ Attitudes and preferences
- ☞ Institutions and policies

## ! Role of Exchange Rates

- ☞ More production is exported
- ☞ Growing importance of world financial markets
- ☞ Exchange rates influence prices
- ☞ World demand and global competitiveness are affected



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**TABLE 1. U.S. Agricultural Exports  
and Imports, 1996**

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<b>Item</b>	<b>Value (\$ million)</b>
<b>Exports:</b>	
Crop Products	49,191
Animal Products	11,254
Total Exports	60,445
<b>Imports:</b>	
Competitive products	25,436
Noncompetitive products	8,207
Total Imports	33,643
Agricultural Trade Balance	26,802

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Source: "Foreign Agricultural Trade of the United States: Calendar Year 1996 Supplement",  
Economic Research Service, U.S. Department of Agriculture, June 1997.



## ! Agriculture and World Trade

- ☞ US agriculture generates trade surplus
- ☞ Crops dominate exports
- ☞ Imports mostly competitive
- ☞ Livestock exports growing
- ☞ Developing nations becoming major markets

## ! Southern Agriculture and World Trade

- ☞ Specialty crops important to agriculture in south (cotton, rice, sugar, tobacco, peanuts, citrus, vegetables)
- ☞ Less government support
- ☞ South is marginal producer of wheat, corn, soybeans
- ☞ South is sensitive to impacts of world events



## ! Globalization and Agriculture

- ☞ Trade issues are complex and interwoven
- ☞ World economic and political events have more impact on US agriculture
- ☞ Trade liberalization will be a major influence
- ☞ Winners and losers will emerge