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PolicyPennings by Dr. Daryll E. Ray

# Would rebalancing currency values increase agricultural exports to China?

Expanding the export of agricultural goods to China has long been promoted as a means of bringing higher prices and prosperity to the US agricultural sector. More than one hundred years ago it was suggested that increasing the length of the shirts of all of the people in China by an inch would absorb the surplus US cotton production bringing prosperity to US cotton producers.

At the time the 1996 Farm Bill was adopted, farmers were told that the high prices of that time would continue because the growing middle class in China would shift from a grain based diet to one that would include more meat. The production of that meat, farmers were told, would require the importation of US corn to feed the required number of poultry and hogs. As we know, that didn't happen and China remains a net exporter of corn.

The present China-is-the-key-to-US-agricultural-prosperity mantra asserts that "the under-valued exchange rate for the Chinese Yuan keeps prices of most…US food and agricultural products more expensive than Chinese products." This concern is the subject of a recently released USDA study, "China Currency Appreciation Would Boost US Agricultural Exports," http://www.ers.usda.gov/publications/WRS0703/.

The question is: If the relationship of the yuan to the US dollar reflected "purchasing power parity," would Chinese imports of US agricultural products increase significantly? The answer is not as clear-cut as the title to the USDA study would suggest.

From our vantage point, there are really two issues. First, if the Chinese currency were devalued, would China's imports of agricultural products show a tremendous increase? Secondly, if China's agricultural imports did increase, would the US be her major supplier?

Let's take the two issues in reverse order. To us, it is important to remember that the US is the residual supplier of bulk commodities like soybeans, corn, and cotton. This means that if our competitors have the ability to increase production, they will have first crack at satisfying any vast upward shift in China imports.

Since countries like Brazil, Argentina and several countries of the former Soviet Union have acreages that can be brought into production, and the multinationals will provide the means for yield increases most everywhere, there seems to be no question that our export competitors will have the ability to increase bulk-commodity production to export to China. Whether there would be much left for the US, would remain to be seen. The USDA is optimistic that if Chinese demand increases, the US will capture much of it. Because the US is the residual supplier of storable commodities, we are not as sure.

Now let's return to the first issue: Would changing the currency exchange rate have much affect on Chinese agricultural imports anyway—regardless of whether the US would be the country that received the import business? The USDA study addresses the importance of the other considerations that may affect China's imports.

The study notes, "China's central leadership, determined to maintain rural social stability, has put a high priority on raising rural incomes. Additionally, China's leaders view reliance on imported grain as a potential threat to food security. Given these policy priorities, China's leadership will be slow to support currency appreciation if it leads to an increase in grain imports."

To us, the paragraphs that deal with these non-currency issues are the report's most important paragraphs because of their recognition of the weight non-currency issues play in Chinese decision making, especially with regard to staples.

How non-staple commodities would be affected by a change in Chinese currency value is trickier. The USDA study argues that the non-staple agricultural products that would benefit the most from an exchange rate adjustment are "US apples, oranges, grapes, cherries, and nuts [which] occupy a high-end market niche [in Chinese retail markets.]"

This is not the argument that we heard in years past. The argument then was that openness in international trade would allow the low labor costs enjoyed by Chinese producers of high-value agricultural products like fruits and vegetables to increase their exports of these products, leaving any growth in agricultural imports to bulk commodities, primarily from the US.

While rebalancing exchange rates between the yuan and the dollar makes sense from a number of perspectives, including its impact on the US trade deficit with China, we are concerned that policy makers be careful not to raise the expectations of US agricultural producers too high. There may be some benefits to US producers, but those benefits might be modest as producers in China and our export competitors adjust to the changes.

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