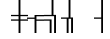


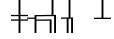
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Outline:

- I. Forces driving globalization of food systems around the world
- II. Manifestations of Globalization
 - A. Trade in Products
 - B. Investment
 1. Direct foreign investment
 2. Licensing
 3. Strategic alliances
- III. How well does our trade theory explain what is going on?
- IV. Implications for firm strategies and public policies
- V. Major Points to cover: Theme: Global Sourcing of Food via Open Economies
 - A. Current events (instability of market) and current stock levels on:
 1. Risk
 2. Food aid
 3. Future price trends and functioning of the market. Implications for developing countries.
 - B. Determinants of competitiveness and implications for trade
 - C. New trade theory and its implications
 - D. Implications for
 1. Producers in HICs–Role of productivity/Value added vs. commodity production–implications for system coordination
 2. Producers in Low income countries–access to new technology and human capital; system coordination; grades and standards
 3. Management of national economic policy in an open economy:
 - a. Scope for protection

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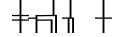


b. Issue of transfer pricing

VI. Supplementary readings on globalization of the World Food System:

- A. Philip C. Abbott and Maury E. Brehdahl. "Competitiveness: Definitions, Useful Concepts and Issues." In Competitiveness in International Food Markets, M.E. Brehdahl, P.C. Abbott and M. Reed, editors, Westview Press: Boulder, CO, 1993 (forthcoming).
- B. Jaakko Kangasniemi. "Trade Policy and the New Trade Theory: A Brief Overview." MSU Agricultural Economics Staff Paper no. 92-26, April, 1992.
- C. Nicholas William Minot. "Contract Farming and Its Effect on Small Farmers in Less Developed Countries." MSU International Development Working Paper no. 31. East Lansing: Dept. of Agricultural Economics, 1986

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- VII. Truism that we live in an more open economy now, and moves towards openness will continue
- A. Due to the changing demands of people--info age, etc.
 - B. Changing nature of production--more mobile factors
 - C. Integration of monetary, commodity, and factor markets have made it very costly for a country to try to isolate itself from the world economy. E.g., attempts at protection for a small country may be offset by exchange-rate adjustments
 - D. Need to think of food policy, including domestic I-O questions within this framework
- VIII. Growing internationalization of world food system over course of human history, with great acceleration in last 30 years. Reasons:
- A. Reduction in transport costs
 - B. Reduction in transaction costs
 - 1. More open economic policies--reduction of trade barriers and development of trading blocs--e.g., European community, NAFTA.
 - 2. Reduction of communications costs
 - 3. Reform of monetary systems in 1970s and integration of commodity and capital markets that ease movement of capital
 - C. Changing consumer tastes
 - 1. Higher incomes lead to demand for variety, fueled by greater contact with rest of the world through:
 - a. Travel abroad--e.g., WWII, US military expansion
 - b. Immigration

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†††† =

2. Similar processes happening in other countries==> as each nation diversifies its diet, globally, there is more homogenization. Spread of McDonalds, Coke, Taco Bell, etc. throughout the world.

D. Technology

1. Possibility of global sourcing of new technology--e.g., through multinationals like Pioneer.
2. Development of synthetics, which means alternative sources of inputs.
3. Biotech

IX. At same time, forces leading away from hierarchical organizational structures in business towards more networking--Reich's analysis.

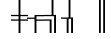
A. More contracting vs. less direct ownership.

B. Reasons:

1. Higher human capital content of production. Can't own ideas like you own physical capital. You can invest and hold physical capital, but ideas are hard to capture==> incentives for independent contracting of services, which are globally mobile--e.g., handout on different factors affecting competitiveness. NB as you develop more differentiated products, human K becomes more important.
2. Lower transaction costs, through e-mail, etc., to transmission of these kinds of networks. These information networks flatten organizational hierarchies.
3. More sophisticated production involves separate components, with some advantages to specialization of these components.
4. Politics--E.g., United Fruit not wanting to be perceived as a plantation owner

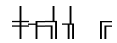
C. Implication, more strategic alliances rather than direct ownership.

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- X. Internationalization in the food system has several manifestations:
 - A. Trade in products
 - 1. This is what people traditionally think of when we talk about internationalization
 - 2. US food system has traditionally been hooked into international trade
 - a. Exports of raw commodities--One of backbones of US development strategy--similar to Canada, Australia, New Zealand. Ag. exports helped fuel the structural transformation of these countries
 - b. Similar for developing countries
 - c. As incomes grew, traditional reliance increased on non-competitive imports--bananas, coffee, tea, cocoa, etc.
 - 3. Major changes in trade patterns in last 30 years
 - a. Shift in world trade away from raw commodities towards higher value products (OH1)
 - (1) Fruits and vegetables
 - (2) More highly processed products
 - (3) More niche products--specialized coffees, organic cotton, etc.
 - (4) Tighter standards--e.g., ISO standards for environmental quality, etc. Grades and standards==>Needs for tighter coordination
 - b. Faster growth of "competitive" imports than non-competitive imports.
 - (1) In 1977, "competitive" imports accounted for 49% of U.S. ag. imports. In 1999, this had risen to 78%.
 - (2) Reasons
 - (a) Reduced trade barriers

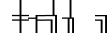
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- (b) Seasonality--especially with growth of trade in fresh fruits and vegetables (**Overhead 4--from USDA trade figures**)--Are these really competitive? Or do they build demand for domestic products by offering year-round supply?--**handout on growth of grape exports from Chile**
- (c) Growth of two-way trade
 - i) In fresh products--e.g., of fruit trade with Mexico. (Source: USDA, Fruit and Tree Nuts, Situation and Outlook, November, 1991)--Similar for vegetables, meat prods (e.g., from Canada)

Year	Exports to Mexico		Imports from Mexico	
	Nominal	Real	Nominal	Real
1986--Value	\$5,690,000	\$5,690,000	\$140,370,000	\$140,370,000
1994 Value	\$184,501,000	\$143,960,410	\$1,537,715,000	\$1,199,831,300
% Change from 1986	3080	2530	1095	
1995 Value	\$85,349,000	\$65,325,766	\$1,847,301,000	\$1,413,916,400
% Change from 1986	1500	1148	1316	1007
% Change from 1994	-54	-54	20	18

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(d) Biggest ag trading ag partners for US (1999 figures)

i) Exports:

- a) Japan (\$8.9 bil)
- b) Canada (\$7.1 bil)
- c) EU (\$6.4)
- d) Mexico (\$5.6 bil)
- e) S. Korea (\$2.5 bil)
- f) Taiwan (\$2.0 bil)
- g) NIS (\$907 million)
- h) China (\$852 million)

ii) Imports:

- a) EC (\$8.0 bil)
- b) Canada (\$8.0 bil)
- c) Mexico (\$4.9 bil)
- d) Brazil (\$1.5 bil)
- e) Australian (\$1.3 bil)

iii) In manufactured products--**Overhead from**

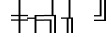
Handy and Henderson, Table 1

- a) Vol of US trade with major partners
- b) Some of this in similar products

4. This represents monopolistic competition--product differentiation

5. Growth in trade of manufactured food products--typically between hics

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6. Intra-firm trade--e.g., over 50% of trade between US and Mexico is within-firm trade.-- Value of Trade Theory?

7. "The end of sovereignty"?

B. Investment

1. For food manufacturers, magnitude of income derived from foreign investment dwarfs that gained thru trade (**Tables 1 and 2 from Handy and Henderson**):

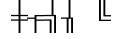
- a. U.S. Exports of food and kindred products in 1990 total \$18.5 billion (compared with \$40.2 billion for ag. exports)
- b. Imports of food and kindred products totaled \$20.9 billion (compared with \$22.6 billion for ag. imports)
- c. In contrast (**Table 2**), shipments from US-owned affiliates abroad in 1988 totaled \$60.3 billion, more than 3 times the value of exports.
- d. 57% of affiliate sales are in Europe. Less than 15% in developing countries.
- e. For largest firms, less than 3% of earnings came from exports, but 22% came from sales by foreign affiliates.

2. Firms can get involved in foreign markets through several options other than trade (trade in headquarter services):

- a. Licensing
- b. Joint ventures
- c. Foreign direct investment

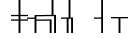
3. Rationale for DFI rather than trade in goods

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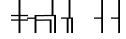
- a. Economics of high value brand names but bulky products (e.g., soft drinks)
 - b. Way of getting around NTBs
 - c. Way to get engaged in policy debates regarding food safety, etc.
 - d. Way of tailoring product to local conditions.
- C. Various contracting arrangements, including licensing, franchises and "strategic alliances)
1. What's involved
 2. Extent
 3. Rationale
 4. Some between LICs and HICs--shift from trade to contract farming, franchising, etc.
 5. Bulk of investment between HICs (**Overhead from Abbott**)
 6. Largest food manufacturing firms European, US, and Japanese (Tables from Handy and Henderson)
 7. As Handy and Henderson show, much of the investment goes both ways--e.g., European firms investing in US and US firms investing in Europe--Table 3 from Handy and Henderson
- XI. Explanation of these trends in trade and investment, in contradiction to traditional trade theory
- A. Traditional trade theory as an extension to the open economy of models of perfect competition.
1. Competitive markets
 2. Heckscher-Ohlin prediction of trade based on relative factor endowments--countries export goods extensive in the country's abundant factor

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3. Trade should therefore be greatest between countries with greatest disparity in factor endowments--i.e., rich countries and poor countries.
 4. Empirical work does not back up this prediction
 - a. Most trade between high-income countries
 - b. Two-way trade in same products
 - c. Factor intensity prediction doesn't always hold (Leontief paradox)
- B. Reasons why old theory doesn't hold:
1. Risk
 2. Imperfect competition
 3. Variation in tastes
 4. Economies of scale
- C. New trade theory--monopolistic competition, economies of scale, and positive externalities
1. Monopolistic competition implies
 - a. product differentiation, and hence niche marketing (2-way trade in similar products). This opens the way for transnational firms to engage in 2-way trade--e.g., between US and Mexico.
 - b. Role of trade in improving domestic competition
 - (1) In importing country by broadening the size of the market
 - (2) In exporting country by honing competitiveness for the export market (more competitive the domestic market, more successful the industry in export markets)
 - (3) Broader the market, the greater the scope for EOS
 2. Economies of scale means that trade may

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- a. Benefit even owners of abundant resources in industries hurt by trade
(e.g., autoworkers)
 - b. Some scope for strategic trade intervention if gov't can pick winners
 3. External economies of scale imply even greater gains from trade since greater volume of market leads to greater external economies in exporting country
- D. Intra-firm trade across borders?
1. Explanation--Williamson on transaction costs--internalization of transactions across boundaries.
 2. Policy issues--problems for national authorities of transfer pricing, allocation of profits across national boundaries, etc.

XII. Policy implications

- A. Importance of international competition/imports in:
1. Generating income in:
 - a. Exporting countries
 - b. Recipient countries of foreign investment
 2. Widening consumer choice
 3. Helping spur domestic competition
- B. Potential benefits of contract farming to transfer tech/limits
- C. Skills needed to participate in various types of products. **Table 1 (Handout and overhead) from Abbott and Bredahl.--role of policy**
- D. "The end of sovereignty"?