
JOINT ECONOMIC COMMITTEE
CHAIRMAN ERIK PAULSEN (R-MN)

REPUBLICAN STAFF STUDY

Soybeans and the U.S.-China Trade Dispute

December 19, 2018

Tariffs' role in the trade dispute. The U.S. government has long urged China to respect the intellectual property rights of American and other foreign companies, allow them to operate without coerced technology transfers, and remove other non-tariff impediments to trade and investment. To induce compliance with international trade and investment norms, the Trump Administration has imposed three rounds of tariffs this year, and threatens a fourth on Chinese imports. China has responded with retaliatory tariffs on U.S. agricultural goods (among other products) in which the United States has a trade surplus with China. On December 2nd, at the conclusion of the G-20 meeting in Argentina, Presidents Trump and Xi Jinping agreed to suspend further tariff increases for at least 90 days, leaving time for negotiations.

China initially imposed tariffs on commodities that cause U.S. producers large revenue losses and that it can readily replace with imports from other countries or domestic substitutes—although at potentially higher costs.[1] Soybeans became an obvious target because they account for about 60 percent of China's $20 billion in U.S. agricultural imports. The tariff on U.S. soybean imports that went into effect on July 6 harms U.S. soybean growers, but also indirectly increases China's cost of supply.

Soybeans are important to China. China's rapid economic development has given rise to a growing middle class that consumes more meat, prompting expanded livestock production and, in turn, increasing China's demand for soybeans as a protein-rich feed.[2] Over the last ten years, China has greatly increased imports of soybeans from the United States and Brazil, the world's two largest producers and exporters of soybeans, and to a lesser extent from Argentina, which is a distant third in world soybean production and exports.

Since 2016, China has been consuming 30 percent of the world's annual soybean production, over 100 million metric tons (MMT) annually, 95 percent of which are imported. In 2017, China purchased about 60 percent of world soybean exports, 54 MMT from Brazil, 32 MMT from the United

Key Points:

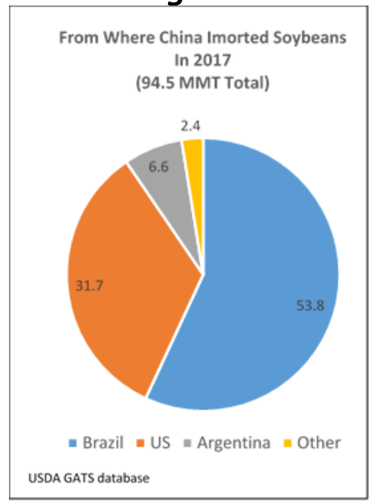
- ***China chose soybeans as an obvious target for tariffs against the U.S. but now is paying a premium for them.***
- ***U.S. agriculture is efficient and flexible, but subject to intermittent geopolitical risks.***
- ***Federal aid lessens soybean growers' losses from China's tariffs, but tariffs have shifted sales to other countries.***
- ***China will become more dependent on Brazil for soybeans if it shuns U.S. imports.***
- ***If China conforms to international norms for trade and investment, mutual gains from trade with the United States can continue.***

[1] Choices, AAEA (Apr. 2018). *What Have We Learned from China's Past Trade Retaliation Strategies*, www.choicesmagazine.org/choices-magazine/submitted-articles/what-have-we-learned-from-chinas-past-trade-retaliation-strategies

[2] FAS, USDA (Mar. 2018). *GAIN Report: China-Peoples Republic of*, www.gain.fas.usda.gov/Recent%20GAIN%20Publications/Oilseeds%20and%20Products%20Annual_Beijing_China%20-%20Peoples%20Republic%20of_3-13-2018.pdf

States, and 7 MMT from Argentina (Figure 1).[3] In all three countries, soybean exports to China account for a large share of domestic soybean production, 78 percent in Brazil, 25 percent in the United States, and 90 percent in Argentina.

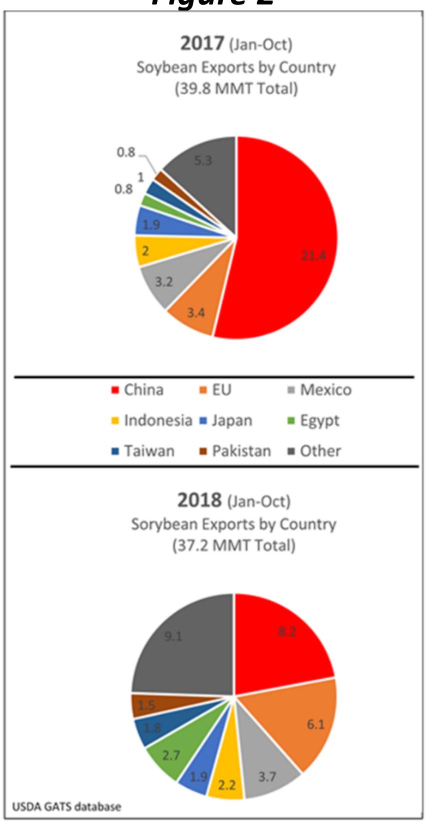
Figure 1



<u>U.S. agriculture: efficient, flexible, and facing geopolitical risk</u>. The United States is an efficient, low-cost producer of many agricultural commodities, making them attractive to other countries. However, U.S. farmers periodically face geopolitical risk. For example, in 1973 the federal government imposed an export embargo on soybeans, cottonseed, and derived products, and in 1980 it imposed a grain embargo against the Soviet Union. Both embargoes led to lower farm prices for affected commodities.

Soybean output in the United States had increased rapidly in recent years to meet growing Chinese import demand, largely by planting on more land in the Central and Northern Plains states. But China's tariffs have contributed to a drop in U.S. soybean sales of almost 14 MMT, causing a surplus of soybeans on the U.S. market.[4] The U.S. soybean export price has fallen by as much as 26 percent from May to September this year.[5] U.S. exporters have shifted sales to other countries (Figure 2)[6] and U.S. farmers are likely to plant more corn and other crops in 2019. Also, some of the land used to grow soybeans for China in North Dakota likely will be left fallow again.

Figure 2



<u>Federal agricultural trade support</u>. Federal programs provide some relief from falling prices and unsold product. The USDA's Market Facilitation Program will provide direct payments to producers affected by retaliation, including an estimated at $7.3 billion to soybean farmers.[7] USDA's Agricultural Marketing Service will administer a Food Purchases and Distribution Program that will buy $1.2 billion of food products. Also, the Foreign Agricultural Service's Agricultural Trade Promotion Program is authorized to spend $200 million on developing export markets.

<u>China's longer-term soybean prospects</u>. In order to curtail its U.S. soybean imports, China is paying a premium for soybeans from other countries and relying more heavily on Brazil as a supplier. Average Brazilian export prices increased nearly 7 percent to $397 per metric ton, up from $372 at the same time last year. As of October 23, the export price of soybeans was $86 per metric ton lower in the United States than in Brazil (Free on Board prices., U.S. Gulf vs. Paranaguá).[8] Soybean demand is projected to continue to grow in China and

[3] Ibid.
[4] Successful Farming (Nov. 2018). *10 PREDICTIONS FOR FARMERS IN 2019*, www.agriculture.com/news/business/10-predictions-for-farmers-in-2019
[5] USDA (Nov. 2018). *Brazil Soybean Transportation*, www.ams.usda.gov/sites/default/files/media/Brazil3rdQuarter2018.pdf
[6] Also see, *Wall Street Journal* (Dec. 12, 2018). "U.S. Soybean Farmers Work to Loosen China's Grip," Of note is that U.S. soybean exports in 2018 initially increased in anticipation of China's tariff going into effect.
[7] USDA (Aug. 2018). www.usda.gov/media/press-releases/2018/08/27/usda-announces-details-assistance-farmers-impacted-unjustified
[8] USDA (Nov. 2018). *Brazil Soybean Transportation, p.2-3*, www.ams.usda.gov/sites/default/files/media/Brazil3rdQuarter2018.pdf.

worldwide.[9] The countries best positioned to substantially increase supply are Brazil and the United States. It is not clear that China itself, Argentina, or other countries can increase production to keep up with demand. Beijing introduced incentives to increase domestic soybean production, but mostly transitioned farmland from feed corn to soybeans[10] increasing domestic soybean output from a decade low of 12 MMT in 2015 to an estimated 16 MMT in 2018.[11] Meanwhile, Chinese domestic soybean consumption increased at a much faster rate.

Brazil scaled up production from 82 MMT in 2012 to 115 MMT in 2017, and the USDA expects it to increase exports by 48 percent over the next decade, possibly enabling it to meet two-thirds or more of the projected increase in China's soybean consumption. Argentina's exports are expected to increase by 6 MMT over the next decade, still accounting for only a modest share of the soybean market.[12]

China also can invest in other countries' soybean supply capabilities, as it is doing in Brazil and Kazakhstan, and higher prices on the world market may induce new supply from non-traditional sources, such as Russia. However, it is uncertain by how much supply may increase and what new political risks may arise. Meanwhile, China is hard-pressed to do without U.S. soybeans entirely.

Conclusion. If China wants to minimize soybean imports from the United States, it likely must continue to pay a significant price premium; it may have to concentrate investment in Brazil to help develop the transportation infrastructure; and it may face political uncertainty from what will become an even larger dominant supplier. The U.S. farm economy is confronting difficulties—which may increase if China imposes additional tariffs—though in time it likely will be able to adjust by supplying other markets, as it has in the past.

If China increasingly turns away from U.S. soybean imports, the mutual gains from that trade will be lost. Alternatively, China could conform more closely to international norms for trade and investment and continue to enjoy the full gains from the U.S. soybean trade. In a hopeful sign, China reportedly made its first major purchase of U.S. soybeans (over 1.5 million tons) since Presidents Trump and Xi Jinping reached a truce in the trade dispute earlier this month.[13]

Gavin Ekins
Senior Economist

[9] USDA projects global trade in soybeans to grow by 34% over the next ten years (to 2027); USDA Agricultural Projections to 2027. Office of the Chief Economist, World Agricultural Outlook Board, U.S. Department of Agriculture. Prepared by the Interagency Agricultural Projections Committee. Long-term Projections Report OCE-2018-1, 117 pp.
[10] ERS, USDA (Nov. 2015). *Development of China's Feed Industry and Demand for Imported Commodities* Feed, www.ers.usda.gov/publications/pub-details/?pubid=36930.
[11] Ibid.
[12] USDA (Feb. 2018). *Agricultural Predictions to 2027*, www.usda.gov/oce/commodity/projections/USDA_Agricultural_Projections_to_2027.pdf.
[13]Reuters (Dec. 12, 2018). *China makes first big U.S. soybean purchase since Trump-Xi truce*, www.reuters.com/article/us-usa-trade-china-soybeans/exclusive-china-makes-first-major-buy-of-u-s-soybeans-since-trump-xi-meet-idUSKBN1OB29S