SASKATCHEWAN WHEAT POOL/KPMG

S.J. Thompson

One of the objectives of this workshop is to discuss private sector response to a trade agreement. In the program rationale, the Coordinating Committee stated it this way:

> But there is another important area that must also adjust in response to the policy trading environment. That is the micro-economy of decision makers, investors, entrepreneurs and others who fund, bear the risks, and produce, process and distribute the products which will be traded... the private sector. At the superficial level, within the private sector, as competitive conditions change in response to changed rules and terms of trade, there will be "winners" and there will be "losers". But we have learned that the economic system which has evolved within the three countries as trade has increased creates entirely new forces and pressures, as well as new opportunities. Investment, finance, exchange rates, business organization, trading rules, and many other conventions take on new challenges within the private sector.

I have been asked to discuss the implications of a Free Trade Area of the Americas (FTAA) for agriculture and to also provide comments and reactions on the earlier sessions. I will focus on the response of agri-businesses by examining the implications of trade agreements on the value chain of a firm (Figure 1). Trade liberalization and economic growth expands the opportunity set of economic activities available to firms and thus allows firms to re-optimize their value chain.

AGRICULTURE AND FTAA

The intent of the 34 countries in the western hemisphere is to reach a free trade agreement by 2005. There has been some discussion about whether the FTAA (Free Trade Area of the Americas) is meant to be a complement or a substitute for existing trade agreements in the hemisphere such as NAFTA, MERCOSUR, the Andean Pact, CACM, and CARICOM. The intent is to complement and co-exist with the regional trade agreements. Sub-regional trade pacts such as NAFTA and MERCOSUR, regional trade pacts such as FTAA, and the more global WTO are seen to provide distinct but complementary paths to freer trade. Furthermore, agreements such as NAFTA, MERCOSUR, and FTAA are seen as key building blocks to economic integration (Ralda, 1997).

Figure 1: Value Chain

Firm Infrastructure

Human Resource Management

Technology Development

Procurement

Supporting Activities

Inbound Logistics	Operations	Outbound Logistics	Marketing and Sales	After-Sale Service

Primary Activities

Negotiations are underway in nine separate areas. During the first phase of the negotiations Canada is the lead country and has named Kent Jespersen as the Chair of the Americas Business Forum. The Americas Business Forum will coordinate input from private sector representatives from the 34 countries in the western hemisphere.

What will be the impact of a FTAA on Canada? According to USDA, the largest export gains for agriculture would accrue to Brazil ($830 million), the Andean countries ($650 million), Canada ($480 million) and Argentina ($350 million) while the largest import increases in agriculture would accrue to the United States ($830 million), Central America and the Caribbean ($780 million), and the Andean group ($580 million). (Burfisher, 1999). The impacts of the integration of the western hemisphere have also been modeled by Diao, Somwaru, and Raney (1998) using a dynamic global general equilibrium model. Their work highlights the importance of the indirect benefits of trade liberalization through investment, productivity gains, and capital flows. It also suggests that although the direct benefits that would accrue to the United States from a FTAA may be small because of its current relative openness, the indirect impacts such as the flow of U.S. capital or direct foreign investment by U.S. firms could be significant. The model also suggests that capital flows either through direct foreign investment or through the demand for U.S. capital replace the flow of U.S. goods over time. Presumably this pattern of economic activity would also apply to Canada.

THE FIRM AND ADJUSTMENT

The ways in which firms adjust to new opportunities from globalization have been extensively discussed by Michael Porter (1994). A firm, according to Porter, is "a collection of discrete but interrelated economic activities - products are assembled, salespeople make sales visits, and orders are processed. These activities involve human resources, physical assets, technologies, routines, and information".

The value chain is a way of decomposing the activities of a firm into supporting and primary activities. The primary activities are: (1) inbound logistics, (2) operations, (3) outbound logistics, (4) marketing and sales, and (5) after-sale service. Support activities include infrastructure such as financing, planning, and investor relations, human resource management, technology development, and procurement. The value chain provides a way to examine the change in opportunities, forces, and pressures that occur as a result of trade agreements and to discuss how firms adjust to these changes.

Firms develop and implement global strategies to gain economies of scale, respond to global market conditions and to efficiently allocate resources. Two distinct strategies are possible. Firms may develop a series of distinct domestic strategies or they may choose to develop an integrated global strategy. The firm's choice will impact the value chain by allowing for different choices in the configuration and coordination of activities of the firm. Trade liberalization and economic growth allow firms an expanded choice set and can add multiple geographic dimensions to the value chain as the firm reconfigures its activities. An evaluation of the new business opportunities may also mean that the firm may withdraw from direct participation in some parts of the chain.

The value chain of an established multi-domestic firm will be quite different from a firm that is just venturing outside its national boundaries. For example, trade liberalization within Latin America has allowed established firms to redesign their business models. The firms have realigned their strategies in response to the expanded opportunity sets within the region. Instead of managing on a country by country basis, business units are combined into regional clusters. The firms have altered their production footprints to take advantage of greater plant specialization, increased intra-region trade, and consolidated operations. The firms have also generally altered their management models. Some of the benefits achieved by these actions include revenue growth, cost reduction, and the ability to attract high quality human resources. Entering firms face different challenges. These firms must determine the potential of the marketplace, develop an entry strategy, and attract and manage human resources. The existence of cultural differences means that partnerships, joint ventures, and alliances may be a better way than a greenfield operation to enter the marketplace (Forteza, 1997).

Going global is not an easy task. Streeter and Bills (1998) have studied the differences in how would be exporters and established apple exporters in the United States viewed the process. Established firms tend to focus on the trade opportunities from the analysis of supply and demand figures. Potential exporters tend to focus on financial risks (a qualified buyers list) and logistics. The established exporters viewed insurance as being a tool to handle logistical and credit risks and were more tolerant of exogenous changes in regulations. Potential exporters were more risk adverse and it was evident that the value chains of these firms were not yet suited to international trade.

As we have seen, logistical gains from liberalization may be significant. Optimizing activities throughout the supply chain can provide revenue growth and reduce costs. A sound credit policy is also important. However, there are many Canadian firms that either don't have or don't implement a credit procedure. To paraphrase the Export Development Corporation of Canada, exports are good but only if you get paid for them.

BURFISHER AND FURTAN

The papers by Burfisher and Furtan provide an excellent discussion of the importance of institutions which provide the rules of the game. Because institutions determine transaction costs, they clearly do impact the choices of firms and thus their configuration, coordination, and profitability. Innovations in institutions that decrease transaction costs reduce the amount of uncertainty that a firm experiences and better decisions regarding resources occur. Furtan's point regarding the relationship between the type of agreement as embodied by the trade-off between institutional sovereignty and institutional integration and the extent of the gains from trade is certainly accurate. Burfisher highlighted some of the institutional innovations that are occurring. The reform of trade policy provides better market access and allows markets to allocate resources more efficiently. Economic growth occurs as this happens.

The second innovation pertained to signals of reputation. Food safety standards and process standards such as ISO9000 allow for freer trade and reduce the risks to both firms and consumers from globalization. The ability of institutions to protect investments by protecting property rights and ensuring contracts are enforceable is extremely important and will significantly influence the actions of firms and governments. The significance of these institutional factors can be seen in recent Russian and Asian financial problems. During the Asian crisis it was clear that many of these nations lacked credible financial rules. The Russian crash of 1998 has certainly altered the investment decisions and sales patterns of agri-businesses.

Innovation by private firms can mitigate some of the risks inherent when institutions lack credibility and create economic returns through collaboration throughout the supply chain. In order to facilitate the development of the food system in the Ukraine, a group of agricultural suppliers such as Monsanto, Case, Dow AgroSciences, DuPont, and the Iowa Export Company in association with the Ukrainian Development Company and the Citizens Network for Foreign Affairs have created the Ukrainian Agricultural Development Company (UADC). UADC is a financial company that allows input suppliers, banks, and commodity traders to share the risk of doing business in the Ukraine by coordinating the financing through out the supply chain of a commodity (Thompson, 1998).

Governments may also provide innovative solutions to the absence of credible institutions. The Canadian government has taken steps to reduce the risk for Canadian firms investing in Latin America. In 1997, the value of planned and actual Canadian investment in Latin America and the Caribbean was about $15 billion.

Canada has been signing Foreign Investment Protection Agreements which are bilateral, reciprocal agreements that offer protection for direct foreign investment through legally binding rights and obligations regarding transparency, dispute settlement, national treatment, and fund transfers (Industry Canada and the Department of Foreign Affairs and International Trade, 1998).

EXCHANGE RATES

Exchange rate volatility and financial crisis do impact firms' strategies. To effectively compete in a global economy requires a more sophisticated approach to risk management. Enterprise risk management provides an optimal process to taking risks and is built upon the elements of corporate culture, procedures, and technology. The losses by Baring Bank of $U.S. 1.5 billion in 1995 and by Orange County of $U.S. 1.7 billion in 1994 occurred because the cultures of these firms allowed irresponsible behavior. Procedures allow the process of risk management to be systematized. For example, market risk limits explicitly show the amount of excessive risk for any portfolio segment. Technology allows information concerning risk to be collected, processed, analyzed, and utilized (Holton, 1996).

Exchange rates also impact investment activity. Economic theory implies that foreign direct investment and exports may be substitutes for one another. A depreciation in the value of a currency increases exports and reduces the outflow of capital for foreign direct investment. Gopinath, Pick, and Vasavada (1998) have found evidence that supports this for the U.S. food processing industry. The authors caution, however, that complementary relationships between foreign direct investment and exports can also occur because of factors such as intermediate products and technology differences.

CONCLUDING COMMENTS

The final aspects of the value chain impacted by trade liberalization that should not be excluded from our consideration concern the environment, the ethics of the firm, and the growth and development of the firm's employees. Direct participation in another economy can increase a firm's risk because of environmental liability. Firms may also face pressure from shareholders and consumers for its labor practices in its foreign operations regardless of whether the practices were unintentional. Because of cultural differences, firms must decide on what ethical principles it will employ outside its traditional geographic boundaries. In order for a firm to successfully participate in an expanded opportunity set, its employees must develop and display enhanced market competency. These issues all highlight the increased informational requirements in the global economy.

The central issue in adjustment appears to be how to create behavioral change. There are three ways that firms and people (because a firm boils down to people) can deal with change. People can react to change, adapt to change, or create change. The company that I worked for, Saskatchewan Wheat Pool, has undergone amazing changes. Three years ago it was a traditional cooperative. Today it is a publicly traded cooperative. The transformation to a market driven company is not over yet.

The crux of the transformation will be to change behavior, or in the words of this conference, cause adjustment to occur. The agri-business environment has changed. Part of my responsibilities were to enhance the contextual understanding of employees and customers so that adjustment could occur. This was not an easy task. The magnitude of the number of books on the subject of business transformation is a good indicator of the difficulty that firms face in creating change.

Communicating the context is an ongoing process. Showing up once a year to talk about change is not adequate. People have to hear the message over and over again. They also have to be able to discuss/argue/debate the context. This year the grain market is depressed, to say the least. The Canadian grain handling and transportation system is slowly moving to being market driven-- in other words, movement starts with a sale. This situation is still not well understand by either employees or producers. Because these groups don't understand the context, they can't accept closures of facilities or part time service. Consequently, some very senior people were assigned the task of going out and discussing this new context with employees so that the front line employees could talk about it with producers.

This conference has talked extensively about education, communication, and dialogue. By creating the contextual understanding we can achieve greater trade liberalization and the resulting economic benefits.

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STRUCTURAL CHANGE IN MEXICO

Andrés Casco/SAGAR

Mexico underwent a deep structural change during its process of developing a coherent agricultural policy. This change occurred in the framework of the agricultural sector so that Mexico could move ahead toward a more market-oriented economy.

We have dealt with four issues:

- The most obvious was the Macroeconomic Stabilization Program in which Mexico has engaged during the last twelve years.

Basically, the Macroeconomic Stabilization Program stabilizes the three main economic variables, the general price index, interest rates and exchange rates.

- The second area was our legal framework.

We had to go through constitutional changes. For those not familiar with Mexico, we recognize three types of properties in our Constitution: private property, public property and ejidos[1]. Although ejidos previously were recognized in our

1 Previously, common land, owned by the government, but managed by local communities.