State of the seed crushing industry

Arnold Mergell of West Germany, president of the International Association of Seed Crushers (IASC), delivered this state-of-the-industry speech at the IASC meeting in New Delhi, India, this past November. In his talk, Mergell notes a decline in oil and meal consumption growth rates as well as increasing competition from indigenous oil crops in developing nations. On the positive side, declining energy costs and decline in the value of the U.S. dollar have helped crushers' operating margins. The upcoming GATT negotiations will be of major interest to crushers, Mergell notes.

It is always a matter of particular pride and pleasure to me, personally, and as president of this association, for our Congress to be held in a country outside of Europe.

This is particularly so on this occasion with the good fortune to meet here in India. It is a country, although customarily classified as developing, which stands out as in a class of its own regarding the scale of its potential development, its influence on the world stage and the impressive achievements which already have taken place.

For the international seed crushing industry, developing countries have been of ever-growing importance as both exporters and importers of edible oils. This congress is our first to be held in a country noted for its major presence in world markets not as an exporter but as an importer of edible oils. India's imports have been in an annual range of 1-1.5 million metric tons (MT) for some years. Total vegetable oil consumption—although spread thinly over the population—is on the order of 5 million MT, and there is a large crushing industry based on domestic oilseed crops of some 14 million MT. We indeed meet in a country of considerable significance in the international seed crushing industry and for world markets.

It is, of course, in the edible oils sector, rather than the meal sector, where the role of developing countries is of particular significance. As with any general statement, one needs immediately to note the exceptions—in this case, the importance of Brazil and Argentina for world meal markets. But in reviewing market developments since our last congress, I would like to focus first on the oil market, with some emphasis on countries that are members of the United Nations Conference on Trade and Development (UNCTAD).

A basic need for profitability in any industry, and seed crushing is no exception, is for expanding markets. For the oil market, it is the developing countries that have contributed a major part of the past growth in the world's consumption of the edible type oils. Unlike the high income countries, these are countries with significant rates of population growth and considerable unfulfilled fat needs. Thus, outside of the centrally planned economy countries of the Soviet Union, Eastern Europe and China, the world's consumption of edible type oils during the past eight years has risen by 9 million MT; of this, developing countries have accounted for more than 7 million MT.

This particular market expansion, averaging 5% a year, has provided support for domestic crushing industries in the developing countries. For those developing countries where imports have been necessary to meet this market expansion, support for crushers elsewhere has come from expanding export outlets for oils.

Unfortunately, an examination—not of this average performance but of the trend from the late 1970s to today—reveals that this support to the international seed crushing industry has been a dwindling one. On the whole, rates of growth in edible oil consumption in the developing world have been declining.

There are some noteworthy exceptions. In India, consumption is expanding faster than in earlier years. In Pakistan, consumption growth has remained rapid, as it also has in Egypt. But taking all other developing countries together as a group, consumption, which in the late 1970s was expanding by nearly 8% a year, is now down to 3% a year.

The regions of most dramatic change have been the Americas, with a growth rate declining to 2% a year from 7%. In Africa (not including Egypt), consumption growth now appears to be not far removed from zero, with lower per capita levels over the past two or three years.

These trends represent a considerable deterioration over time in the market environment faced by domestic seed crushing industries in such countries. Moreover, because of the impact of these consumption trends on edible oil imports into developing countries, crushers elsewhere, such as in the U.S., South America and Europe, with significant export sales suffered even more serious deterioration in their market environment. There are the developing countries mentioned earlier which provide exceptions to this generalization. In Egypt, sizable increase in edible oil consumption continues to be associated with rising import levels of cottonseed and sunflowerseed.

Pakistan's edible oil imports have continued upward to match rising consumption levels. In India, imports have remained large, although rising consumption needs have been met from larger domestic crops.

Consequently, while import levels have fluctuated from year to year with changes in domestic crops and stocks, these fluctuations have essentially been around a flat import trend line since the late 1970s.

In all other developing countries taken together, however, the rate of expansion in edible oil imports has slowed down dramatically. These oil markets for exporters amounting to some 3.75 million MT have shown only small growth since the 1981/82 season, with an average gain of 3% a year. By contrast, over the four years prior to 1981/82, these markets for oil exporters expanded on average by 13% a year over that period, or 1.3 million MT.

For the international seed crushing industry, therefore, the underlying conditions in the world edible oil markets have not only been deteriorating in the 1980s compared with the strong support to the industry given in the late 1970s, but have been doing so in quite a dramatic way. Moreover, within this deteriorating market situation for edible oils in total, seed crushers have had to face the ever-intensifying competitive pressures from palm oil. Ten years ago, the combined production of palm oil in Malaysia and Indonesia was 1.8 million MT—a figure that almost seems insignificant when compared with the 6 million MT produced in the past 12 months.

This pressure on seed crushers is evident in the rising share of palm oil in the total edible oil imports of India and Pakistan. And for all other developing countries as a group, palm oil now provides more than 30% of their total edible oil imports, compared with 20% at the beginning of the 1980s.

This longer-term deterioration in the underlying support for the international seed crushing industry from the edible oils market has hardly provided a sound base from which to face the intensified and particular pressures on seed crushers that have characterized the period since our last congress in May 1985. At that time, there seemed to be some grounds for guarded optimism that adequate crushing margins would follow the improved availability of seed supplies. Moreover, in the season just ended, seed supplies increased further. In the U.S., the soybean crop increased by 6.5 million MT—the result of record yields on plantings—7% less than in the previous year, but more than adequate to offset the drought-reduced Brazilian crop. New peaks were also registered for the Argentine soybean crop. In the EEC's rapeseed and sunflowerseed crops and for copra crushers in the Philippines, the supply recovery from the drought-affected, exceptionally low level of the previous season was dramatic.

Unfortunately, the benefit to gross crushing margins from ample seed supplies has been swamped by the adverse effects of developments in product markets. Crushing capacities have not been fully utilized, not because of the inadequacies of seed supplies but because of the inadequacies of markets. Consequently, since our last congress, the international seed crushing industry has again had to face deteriorating margins and a period of poor profitability.

In the edible oils market, it hardly needs to be said that the past season saw the development of one of the largest oil surplus situations ever experienced. Since our last congress, the price of soybean oil in dollars has about halved, while oils such as palm and coconut are a third of their earlier levels. There is hardly a time in the past 40 years where one can identify oil prices as having been lower in real terms than they are today. When palm oil producers complain that prices are below production costs, we can be sure that prices are very low indeed.

Such price developments are a reflection of the intensity with which seed crushers and other oil suppliers are having to compete for available markets. For seed crushers, however, intense competitive pressure for markets invariably results also in a squeeze on margins as seed prices fall less than product prices. This has been the situation since the last congress, with the squeeze on margins exacerbated by some particular features of the market.

The most important feature was the intensified competitive pressure faced by seed oils from the massive increase in palm oil production. In the 1985/86 season, the combined production of palm oil in Malaysia and Indonesia was 27% higher, or 1.3 million MT more, than in 1984/85. The sheer size of this increase is best indicated by remembering that it is about as large as the normal annual increase in the whole world's consumption of all edible oils. In Indonesia, it was largely the result of increases in the bearing acreage from the substantial plantings in earlier years. In Malaysia, it was the consequence of record yields significantly above a long-term trend and 35% higher than the low yields of three years earlier.

Given such palm oil developments, it is not surprising that the world oils market has been in major surplus nor that seed crushers faced with such competition have been confronted with what I might euphemistically describe as a period of great challenge. These supply pressures on margins, however, were further intensified by the weakening of world import demand for seed oils—a statement one can make solely on the basis of developments here in India.

In the 1984/85 season, India's combined imports of palm, soybean and rapeseed oils were some 1.5 million MT—a level which made India the market for 20% of the world's exports of these oils. Over the 1985/86 season, India's imports dropped to little more than a million MT, which because of the dominance of the Indian market was equivalent to a drop of 6% in total world demand for these oils. Moreover, the whole of this reduction in India's imports was borne by soybean and rapeseed oils, with the level of palm oil imports maintained. Hence, for crushers of soybeans and rapeseed supplying the India market, these developments were equivalent to a 10% reduction in the total world import demand for these two oils.

This sharp change in Indian import levels was not the result of lower consumption, which indeed continues to increase, nor of a large swing in domestic oilseed crops. It was instead the consequence of previously accumulated stocks being reduced. And since this cannot be repeated, it offers some prospect of higher Indian import demand in the present season, although much will depend on the still uncertain size of this season's domestic crops. What is certain on a longer time scale is the government's intention through the National Oilseeds Development Board to expand domestic oilseed crops to reduce still further imports of edible oils.

The substantial effort required to achieve this objective is being well realized. We observe that crop levels have already increased in the 1980s compared with the relative stability of earlier periods. The present normality for the rapeseed crop is some 3 million rather than 2 million MT; a soybean crop approaching 1.5 million MT compares with 500,000 MT, while the sunflowerseed crop has increased from one of little significance to nearly 500,000 MT. Even for groundnuts, the major oilseed crop requiring large scale efforts, higher production levels are now being achieved than those prior to 1980.

India is not the only country seeking to limit edible oil imports by expanding domestic production. One may note, for example, the expansion of palm oil production in Colombia and Ecuador; overseas crushers will naturally be concerned at the constraint to growth in export markets from such developments.

However, it must also be remembered that a healthy and efficient expansion of agricultural sectors in developing countries plays a vital role in generating overall economic growth. This itself is vital for expanding product markets with a place for both domestic suppliers and imports. On the other hand, it is equally important for countries intent on policies of self-sufficiency in one sector, such as oilseeds, to bear in mind that the diversion of scarce national resources from alternative uses implied by such policies may not in the end be the most effective way either of maximizing economic growth or of improving the balance between foreign exchange earnings and expenditures.

These longer-term developments in the world edible oils market and the particular features of the past 18 months have undoubtedly been of considerable significance in the longer-term pressures on the profitability of the international seed crushing industry and the intensification of those pressures.

These less-than-favorable developments over time in the world oil markets can be related, so far as developing countries are concerned, to the sharply reduced rates of economic growth during the 1980s compared with the 1970s. Typical of the 1970s were annual growth rates of 5-6%, but growth had virtually stopped at the end of the world recession in 1983. Some recovery since then probably still leaves developing countries expanding at no more than half the rate of the late 1970s. Foreign exchange problems have become acute, partly because of the high servicing costs of heavy international borrowing that supported economic growth in the 1970s, partly because of the 40% drop in the net flow of funds to developing countries and partly because of the impact of lower commodity prices on exchange earnings.

It is no coincidence that the more dramatic slowdown in the expansion in edible oil markets also occurred in Latin America and Africa; these rather than Asia suffered the more serious cutbacks in economic growth.

To offset the effect on profitability in the international seed crushing industry of the longer-term deterioration in the oil market environment would have required substantial strength over time in the meal markets. However, up to the time of our last congress, longer-term developments in the major meal markets showed some similarities to those of the edible oils market—adding to, rather than alleviating, the pressures on seed crushers.

In the U.S., soybean meal consumption rose by over 50%, or six million MT, in the last five years of the 1970s, but since then has shown no further expansion. In Eastern Europe, total meal consumption is now less than at the beginning of the decade after expanding 5% a year in earlier years, with a more dramatic change in the Soviet Union.

In the five years up to the 1982/83 season, total meal consumption rose by 45%, and overseas crushers found the soybean meal market expanding from zero to 2.8 million MT. Within two years, total meal consumption in the USSR had dropped to its earlier level, with all but a small part of this market lost to overseas crushers.

The pattern in the 12 member-countries of the EEC also has been one of substantial expansion in meal consumption in the 1970s, virtually grinding to a halt up to the 1984/85 season. Within this total level, groundnut meal consumption declined sharply due to aflatoxins; crushers of rapeseed and sunflowerseed substantially expanded their shares of the market as domestic crops increased, leaving soybean crushers in the EEC and elsewhere faced with a relatively static meal market.

Over the 1980s, competitive pressures in meal markets have also intensified—partly from corn gluten, with EEC net imports rising from 2.3 million MT to an estimated 3.8 million MT in 1985/86, but also from China, which has emerged as a major exporter of meals. Total meal exports were negligible prior to 1980 but seem likely to have reached a total of 1.5 MT over the past 12 months, comprised of 750,000 MT of soybean meal, 0.5 MT of rapeseed meal and the balance largely of cottonseed meal.

This longer-term pattern of static and/or declining meal markets established since 1980 has changed in some regions during the past 12 months and, in contrast to the oil situation, has provided some much-needed support to crushing operations. The most pronounced change has been in the EEC. Preliminary estimates of total meal consumption in the 1985/86 season indicate a rise of nearly 2.5 MT, or 9%, from the consumption levels of the 1984/85 season—an increase shared by all meals, with the increase in soybean meal consumption approaching one million MT.

A major factor in this substantial change in the EEC meal market has been the effect of reduced internal prices as a consequence of the depreciation of the U.S. dollar since its peak in March 1985. At that time, meal prices were over 500 deutsche marks (DM) per metric ton and are now under 400 DM, despite an upward movement in meal prices expressed in dollars. This has contributed to lower feed costs and higher profitability in the livestock industry. As a result, there have been some noteworthy increases in the number of animals to be fed. Around mid-1986, pig numbers were up 10% from the previous year in the Netherlands, 6% in France and 4% in Germany. Moreover, with relatively fixed prices for cereals under the CAP, the meal price ratio to cereals moved down to a level more favorable to meal than at any time in the last 10 years.

The associated expansion in the EEC crush (albeit with profitability under pressure from the surplus of edible oils) contrasts with the U.S. situation, where the domestic offtake of meals was some 3% lower in the 1985/86 season than in 1984/85. The major surplus of feed grains combined with cuts in government price supports have sharply reduced feed grain prices. One consequence of the reduction in feed costs has been a highly profitable livestock sector. The hog/corn ratio, for example, has been at its highest level since these records were first established in 1909. This offers prospects of expanding meal markets for the future. More immediately, however, and in absolute contrast to the EEC, meal has become uncompetitive in feed formulations against cereals, with the meal/maize price ratio recently close to 2.5, compared with the usually defined competitive level of 1.8. The dampening effect of the consequent reduction in meal consumption on U.S. crushing activity was eased only by an expansion in meal exports of 1.5 million MT, which filled the gap left by Brazil following its low soybean crop resulting from adverse weather conditions.

The Soviet Union can be identified as an area where meal consumption rose sharply in 1985/86. Soybean meal consumption is estimated to have reached 2 million MT. Although still well below the earlier peak of 3.3 million MT, it was sharply above the 1.1 million MT of 1984/85. Maybe this represents a once-and-for-all upward adjustment from the 1984/85 level, which was deemed to be intolerably low. But given the well-recognized need in Russia for much greater protein inclusion in animal feedstuffs, it may also be that a new expansionary phase in Russian meal consumption is now under way. The benefit to overseas crushers in the form of greater meal export opportunities was limited in 1985/86, since higher consumption was met largely from higher soybean, rather than meal, imports. But, with the Russian soybean crush now restored to levels typical of earlier years, there are perhaps more prospects for renewed expansion in this meal market for overseas crushers.

Overall, the experiences of our industry since the last congress can be summarized as an intensification of pressures from longer-term unfavorable developments in edible oil markets but with some reversal of the longer-term unfavorable situation insofar as meal markets are concerned. Prices and price relationships with competing materials and government policies affecting these have significant influences on our industry. In the end, the key factors for sustained profitability for the international seed crushing industry are the achievement of good, sustained and balanced world economic growth and an accompanying expansion in product markets.

It is in recognition of this fact and a recognition of the damage done to world economic growth prospects by protectionist measures that this association has consistently endorsed the philosophy of a liberalized world trading system and spoken against protective, trade-distorting measures that have appeared from time to time within our own industry. It is all too easy, particularly for politicians, to see the short-term benefits of protection and subsidies in particular cases. But in the longer term, the inevitable countermeasures, bringing a multiplication and escalation of protectionist devices, constrain world economic expansion, to which the fortunes of our industry are so closely related. This is not an expression of fears for the future. Unfortunately, it is a description of the events of recent years, as protectionist pressures in industrial sectors were first stirred by the world recession and then intensified in the U.S. by an overvalued dollar. More recently, major agricultural surpluses from protected and supported production have seen competitive subsidization of exports and mounting tensions, bringing the EEC and the U.S. to the brink of a trade war in farm products.

These various aspects of the world environment characterize the 1980s as a period in which that environment was particularly unfavorable for sustaining satisfactory profitability in the international seed crushing industry. They have induced major structural changes and rationalizing within our industry in the U.S. and in Europe. However, there are perhaps some grounds for optimism for an improving world environment as we move toward the end of this decade.

In the first place, it is to be hoped that the slide toward greater protectionism in world trade and the threat that this poses to future world economic growth will be reversed through the new round of multinational trade negotiations within the GATT. This was launched—after much brinkmanship—at the Ministerial Meeting in September, setting the terms and framework for the negotiations. Many years of complex and difficult negotiations will be involved. Unlike in the past, the emphasis will be less on tariff levels, which have become less important as protectionist measures, than on nontariff barriers and other trade-distorting devices. In particular, at the insistence of the U.S., negotiations will break new ground by seeking to reduce agricultural protection in Europe, the U.S. and elsewhere and the competitive subsidization of exports, which are blamed for global overproduction and disruption of world markets. It takes little to imagine the acute negotiating difficulties in this area, given that domestic market protection and export subsidies are at the root of the EEC's whole CAP regime, while the U.S. sees their reduction as one of the most crucial issues in the negotiations.

Nevertheless, while it will be a long time before results are forthcoming from these negotiations, their importance at this time lies in the fact that the first positive and necessary step has been taken by the 92 member-nations of GATT to get together and seek ways to reverse recent protectionist trends. It offers the hope that ultimately the world will move toward a trading environment more favorable to world economic growth than at present. These are early days, but to contemplate the collapse or failure of these negotiations is to raise the spectre of escalating competitive protectionism and world economic depression akin to the 1930s. One must fervently hope for a successful outcome, for such an outcome is vitally important to the long-term health of our industry.

In the nearer term, there also appears to be grounds for optimism about the future economic environment within which our industry operates as a result of the sharp fall in energy prices. It offers prospects of faster economic growth in the industrialized world, with feedback to the developing countries to enhance the direct benefits of cheaper oil to the 70 or so developing countries, with a population of three billion, that are not oil importers. In addition, declining interest rates and a return to low inflation rates in industrialized countries are features that must be viewed as favorable for the future world economic environment.

It is these three features that already have been of direct benefit to our industry to offset some of the difficulties posed by an unfavorable market environment. For a period in the 1980s, our industry and its net margin and profitability were increasingly squeezed between two pressures. On the one hand, the deteriorating market environment for oil and meal was putting downward pressure on gross crushing margins, while at the same time, severe upward pressure on costs was experienced resulting from energy prices, interest rates and high inflation. The reversal of those cost pressures has helped our industry cope with the difficult market conditions, with further easing of those pressures since our last congress.

But, of course, the more dramatic change has been the slump in mineral oil prices to $15 per barrel—having been below $10 in the earlier part of 1986—compared with $28 per barrel at the time of our last congress. The depreciation of the U.S. dollar generated an even sharper fall in local currencies—the equivalent fall in deutsche marks, for example, would be some 65%. While the precise effect on energy costs in each country differs with changes in national taxes, a sizeable cost reduction for the crushing industry is not in doubt.

All these developments in the world economic environment, whether influencing market growth or cost structures, have a crucial impact on profitability levels. While this is a statement one could make generally about almost any industry, it is more particularly true and especially relevant to seed crushing. Gross margins are small in relation to the value of materials flowing into and out of our mills and are highly sensitive to market conditions. The industry has no direct way of immediately passing cost increases on to consumers with our selling price set by a world market situation; in addition, marketing efforts can only maximize opportunity set by the environment rather than cause the environment to be different.

The fact that there are major influences on our profitability that are outside our control heightens the need for attention to areas within the industry where profitability can be directly affected. This hardly needs to be said at the company level, but it is a clear responsibility of the IASC to bring the full weight of the industry to bear on matters important for the overall profitability of international seed crushing. The IASC would wish the USSR, for example, to know of IASC opposition to the harsh contract terms being introduced for its commodity purchases. They are not terms that suppliers can reasonably satisfy. Terms such as the option to return total shipments not meeting specified contract requirements to the seller at the seller's expense and to make deductions from payments due for in-transit damage are too far removed from standard trading practices to be acceptable.

The quality of U.S. soybeans received by importing countries is always an important concern for overseas crushers. At a meeting with the U.S. Federal Grain Inspection Service, the IASC opposed the revision of the U.S. standards for soybeans to delete moisture as a grade-determining factor. Unfortunately, we were not successful, and this revision became effective in September 1985. Nevertheless, the potential adverse effect of high moisture content on bean quality, refining yields, product quality, crushing costs and margins is such that pressure will be maintained to seek the restoration of moisture as a grade-determining factor.

Highlighting these areas emphasizes the importance and value of the ongoing involvement on such matters of IASC members and the IASC committees. Thanks and appreciation are always due for their devoted efforts on behalf of the whole industry to ensure our maximum ability to meet the challenges of unfavorable market environments and to grasp all the opportunities of favorable periods.

On the whole, challenges have dominated this industry for a number of years, with a deteriorating market environment and cost pressures. However, the easing of cost pressures and the prospects for an improving world economic environment give me some grounds for optimism that if in the future we look back to the present, we shall see it as a turning point where opportunities for profitable growth replaced challenges as the dominant feature of the international seed crushing industry.