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AGRICULTURE AND THE NORTH AMERICAN FREE TRADE AGREEMENT

by Gary W. Williams
and C. Parr Rosson, III

Under pressure from a wide range of interest groups and the scrutiny of the national media, U.S., Mexican, and Canadian trade negotiators recently completed a North American Free Trade Agreement (NAFTA). If approved by the national legislative bodies in all three countries, NAFTA will become the world's largest free trade area—360 million people producing \$6.2 trillion of goods and services and exporting and importing more than \$1 trillion worth of goods.

Proponents claim that the proposed agreement will expand trade, boost economic growth, and lead to a net increase in employment in all three countries. In contrast, critics warn that U.S. workers will lose jobs as lower trade barriers with Mexico encourage many U.S. industries to move to Mexico to take advantage of low cost labor and less environmental and other government regulation. For agriculture, proponents argue that NAFTA will open the door to large new markets for exports of U.S. agricultural and food products, especially feedgrains, beef, and processed foods to Mexico. Critics claim that the agreement will stimulate Mexican farm production and exports to the United States and even relocation of U.S. production and processing to Mexico.

Why A NAFTA?

At least three historical events combined to motivate the negotiation of a NAFTA. First, the 1989 U.S.-Canada Free Trade Agree-

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ment set the stage and served as a prototype for the negotiation of this broader agreement. Second, the difficulty of achieving a new GATT agreement and the progressive harmonization of internal European Community (EC) markets have encouraged the United States to foster a counterbalancing trading bloc in the Western Hemisphere. Third, sweeping economic reform in Mexico over the last 5 years has included liberalization of its trading rules with or without a trade agreement with the United States and Canada. Mexico has already made unilateral cuts in tariffs and non-tariff barriers, privatized government-controlled industries, made investment by foreign enterprises easier, and enacted historic land reform legislation even without an agreement.

NAFTA Agricultural Trade

Mexico is already a major agricultural trading partner of the United States (*see adjacent figures*). It is the third largest market for U.S. agricultural exports, purchasing food and fiber valued at \$2.9 billion in 1991, up 9 percent from 1990. Mexico represents the largest market for U.S. grain sorghum and the second largest market after Japan for U.S. meat and meat products.

U.S. agricultural imports from Mexico have also risen dramatically up to \$2.5 billion in 1991, making Mexico second only to Canada as a supplier of foods to the United States. Mexico is the major source of fresh fruits, vegetables, and live cattle for the United States, the second largest source for orange juice, and the third largest source for coffee after Brazil and Colombia.

At the same time, Canada-Mexico agricultural trade is relatively small. Mexico accounts for only 1 percent of Canadian agricultural exports and supplies only 2 percent of Canadian agricultural imports. Canadian exports to Mexico were valued at only \$100

million in 1990, including mainly wheat, canola, dairy products, barley, beef, pork, live cattle, and hogs. Since Canada-Mexico agricultural trade is so small, this article focuses primarily on the NAFTA implications for U.S.-Mexico agricultural trade.

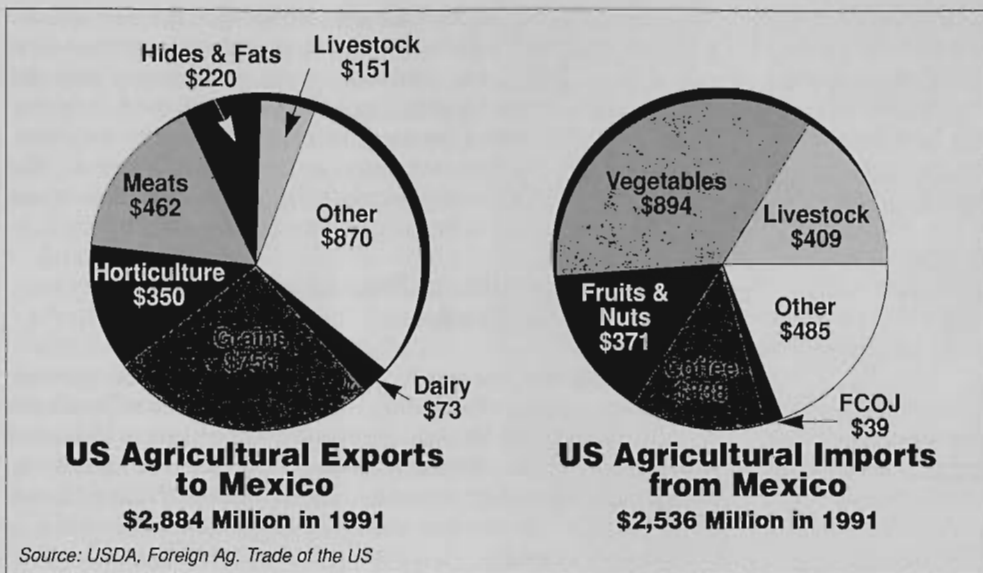
Mexican Liberalization —Pre NAFTA

For many years Mexico embraced an economic development strategy emphasizing import substitution. However, mounting external debt and the economic crisis in the early 1980s forced a change in policy to more open markets and trade. Mexico acceded to the General Agreement on Tariffs and Trade (GATT) in 1986, a step that obligated Mexico to reduce its average import tariff level from around 80 percent to about 50 percent. Mexico, however, unilaterally went much further than required and reduced its average tariff level to between 10 percent and 20 percent.

Mexico has also unilaterally eliminated the import licensing requirement for many agricultural products. However, over 25 percent of all U.S. agricultural exports to Mexico are still subject to import licensing. Mexico also uses more passive forms of trade restrictions, such as trucking regulations which prevent U.S. trucks from operating within Mexico. But these problems are not one-sided. For example, Mexicans argue that U.S. marketing orders restrict trade.

Other policies and regulations also affect U.S.-Mexico agricultural trade, including farm price supports in each country and differences in the levels and enforcement of commodity grades and

> U.S. agriculture as a whole will be a NAFTA winner. However, some parts of U.S. agriculture will lose. Likely immediate winners include cattle and hog feeders, meat processors, grain and oilseed producers and processors, dairy producers and processors, and producers of some fruits. In contrast, labor-intensive vegetable and melon producers will likely be adversely affected. However, even fruit and vegetable producers could be eventual winners if strong economic growth in Mexico creates rapid expansion of Mexican demand for these products.



because relatively few import barriers remain to be eliminated, and the remaining U.S.-Mexico trade barriers are to be only gradually eliminated over 5, 10, or 15 years. In addition, the agreement provides for tariff-rate quotas (TRQs) to protect against import surges in both the United States and Mexico for some key products.

The longer-run NAFTA effects on U.S.-Mexico agricultural trade depend crucially on several factors:

- Underlying comparative advantage,
- Mexico's economic growth,
- Foreign investment in Mexico,
- Mexican farm size and structure,
- Mexican labor markets and costs, and
- Availability of new production inputs in Mexico.

Underlying Comparative Advantage.

Removing the barriers to trade among countries reveals their underlying comparative advantages. Comparing costs of production can provide some notion of those underlying advantages but is hazardous in many respects. Cook and associates compare U.S. and Mexican fruit and vegetable costs of production and conclude that Mexico has a clear advantage in asparagus, fresh strawberries, fresh tomatoes, bell peppers, squash, and cucumbers.

In contrast, they conclude that the United States has lower production costs for eggplant, cantaloupe, apples, and peaches. For other commodities, such as broccoli and tomatoes for processing, some U.S. regions appear to have lower, and others, higher production costs than Mexico. Adding in transportation and marketing costs, however, likely reduces the Mexican advantage for many vegetables and melons significantly as pointed out by Gomez and associates.

Besides horticultural products, Mexico appears to have an advantage in feeder cattle production given current relative levels of technology, the relative availability of cheap, non-irrigated grazing lands in Mexico, limited Mexican water resources available for feed production, and relatively lower labor costs in Mexico.

The United States has an apparent advantage in livestock feeding, meat production, and dairy operations based primarily on access to abundant supplies of relatively low cost U.S. feedgrains and more advanced production and processing technologies. A U.S. advantage in feedgrain production likely results from higher yields, more advanced technology, and abundant availability of highly fertile soils for crop production with adequate rainfall or groundwater for irrigation.

Economic Growth in Mexico. The most important factor likely to affect U.S. farm export potential to Mexico is future growth in Mexican per capita incomes rather than further reductions in Mexican trade barriers. Thus, the critical issue for U.S. farm exports to Mexico is the effect of NAFTA on Mexican jobs, employment, and incomes. Absent significant income growth, Mexican food demand would grow only slowly or even decline. Consequently, the Mexican market for farm products would continue to be supplied mainly by Mexican producers.

Foreign Investment. Foreign capital to lift Mexican capacity, technology, and infrastructure constraints is needed for Mexico to achieve its export potential. Also, such investments are key to U.S. export potential to Mexico. Foreign capital is an important source of expected growth in employment, incomes, and, in turn, the demand for food in Mexico.

Mexican Farm Size and Structure. Although popular in Mexi-

standards, chemical use regulations, food residue regulations, insect and disease control standards, and others. Inconsistent, complex, and lengthy administrative procedures at border crossings also affect that trade. NAFTA does not address all these issues.

The NAFTA Legislative Process

The procedures for considering the NAFTA by the U.S. Government are very specific. On August 12, 1992, the governments of the 3 NAFTA countries announced that a tentative agreement had been reached. Private Sector Advisory committees in the United States evaluated the agreement and then submitted final reports to the U.S. Congress, the President, and the U.S. Trade Representative. The President notified Congress on September 18 of his intent to enter NAFTA. However, the President may not sign the agreement until 90 calendar days have elapsed following notification of Congress (December 17, 1992). During this 90-day period, the House Ways and Means Committee and the Senate Finance Committee, along with any other committees having jurisdiction over trade matters, will consult with the President to consider how and to what extent the agreement will achieve its stated purposes and to develop implementing legislation. The legislative process will include both public hearings and legislative debate.

While the agreement cannot be signed before December 17, 1992, under current law, it must be signed by the President before June 1, 1993, if it is to be considered by the U.S. Congress under "fast track" authority. Once the agreement is signed by the President, implementing legislation may be submitted. Fast track requires the implementing legislation to be voted upon without amendment within 90 legislative session days of it being submitted. Thus, the earliest that NAFTA could receive Congressional consideration would be late spring or early summer 1993, and it would not become effective until January 1, 1994.

Will NAFTA Make A Difference?

NAFTA proponents argue that Mexico is a potentially huge, new market for U.S. agricultural products. That may be the case, but the proposed NAFTA will likely not be the primary reason, at least not in the short run. Over the last 5 years, Mexico has opened markets long closed to international trade and the effects on Mexican trade already are evident. In contrast, the effects of NAFTA tariff and non-tariff changes on U.S. agricultural exports and imports will likely be small. This is the case primarily

co, especially among the rural poor, the land tenure laws that created the *ejido* system in the 1930s have been blamed for the poor performance of the Mexican agricultural sector and are considered one of the biggest constraints on productivity growth in Mexican agriculture. *Ejidors* account for 50 percent of the land area of the entire country, often consist of low quality land, and average 2 to 10 acres each. *Ejidors* generally lack access to commercial communication and efficient marketing channels.

The Salinas Administration recently pushed land reform legislation through the Mexican Congress. If effectively implemented, the legislation could promote growth in farm size, a decline in the total number of farmers in Mexico, and increased efficiency and competitiveness of the Mexican farm sector.

The new legislation allows *ejidatarios* (*ejido* farmers) to sell or rent their land—practices prohibited under the old land tenure system. This change will permit the more efficient, private Mexican farming operations to legally expand production through buying or renting *ejido* land. The number of hectares an individual or corporation can own is still quite restricted by law, however.

Ejidatarios can also now legally respond to a decline in the profitability of crops relative to livestock production by converting crop acreage to pasture. The size and number of corporate-owned farms will probably increase, as will the number of legal joint ventures with foreign companies. And, U.S. investors may now legally set up agricultural operations in Mexico.

Mexican Labor Markets and Costs. Critics of NAFTA often point to the low wages in Mexico relative to U.S. wages. Relative wage rates is an important issue for agriculture since Mexican agriculture is relatively labor intensive. In fact, a short term effect of NAFTA may be downward pressure on Mexican wage rates as increased agricultural imports from the United States displace Mexican agricultural labor in import-competing sectors. The consequence could be increased competitive advantage of Mexican labor-intensive sectors like fruits and vegetables and greater pressure for migration of undocumented Mexican labor to the United States.

Over the longer run, if NAFTA fosters sufficient economic growth in Mexico to absorb the displaced labor, wage rates could recover and eliminate the short-run Mexican gains from low-cost labor. Again, however, the role of NAFTA in generating economic growth in Mexico is critical.

New Production Inputs. NAFTA will enhance the availability of critical agricultural inputs, such as new and used farm equip-

ment, spare parts, improved seeds, breeding stock and genetic material, feeds and additives for animal nutrition, and technical consulting to help lower production costs and improve land and labor productivity in Mexico. The Mexican Government, however, is continuing to reduce government farm subsidies for irrigation, fertilizer, fuel and lubricants, credit, and technical assistance. The net effect may be relatively less availability of these critical inputs to small farmers than to larger, commercial farms in Mexico.

Effects on Agricultural Production, Processing, and Trade

Neither patterns nor trends in agricultural production, processing, or trade among the NAFTA countries are likely to be altered significantly by NAFTA. Any changes are more likely to be caused by improved market efficiency and economic growth in Mexico as economic restructuring continues, and as increased domestic and foreign capital investments are made in productive activities in the Mexican economy.

We expect NAFTA to primarily facilitate continued expansion of U.S. exports to Mexico of feedgrains, wheat, oilseeds, meats, dairy products, selected fruits and vegetables, cotton, tobacco, and a wide variety of further processed and consumer-ready food products. On the other hand, NAFTA will increase the competitiveness of several Mexican agricultural industries, including labor-intensive melon and vegetable production and possibly cow-calf production to the benefit of U.S. consumers.

Horticultural Products. A NAFTA would likely boost U.S. imports of traditionally traded Mexican horticultural goods and those on which the United States has imposed a high duty. These include asparagus, tomatoes, lettuce, bell peppers, cucumbers, green chilies, squash, avocados, grapes, guavas, and mangoes. Imports of other Mexican horticultural products, such as broccoli, cauliflower, melons, eggplant, onions, and okra might also tend to increase, although Mexico is less competitive in these products.

NAFTA will likely boost U.S. exports to Mexico of primarily temperate-climate products, such as potatoes, apples, pears, peaches, and processed foods such as dried leguminous vegetables and corn.

Again there is a question of the prospective balance between Mexican demand growth and production increases. Demand associated with Mexican economic and per capita income growth could outpace the ability of the Mexican fruit and vegetable industry to supply the growing fruit and vegetable markets in both countries. This is likely to be the case if critically needed Mexican public investments in infrastructure and foreign and domestic investments in Mexican fruit and vegetable production and processing capacity, technology, and irrigation capacity are not made.

Citrus and Citrus Products. Because U.S. import tariffs on these products are already relatively low, NAFTA will have only a small additional impact on U.S. imports of Mexican citrus. Non-tariff issues such as phytosanitary regulations to control the spread of insects, particularly the Mexican fruit fly, and pathogens harmful to citrus, and differences in other grades and standards and food safety regulations will continue to be the major policy issues facing fresh citrus imports from Mexico. A major question is the possible effect of increased economic growth in Mexico.

Non-bearing citrus acreage is about 45 percent of current citrus acreage and is expected to begin production in 3 to 5 years. Most of the new production will likely be for juice processing. Increased capital investments in Mexican citrus processing facilities as a result of a NAFTA could boost U.S. orange juice imports from Mexico.

Grains. Mexico has already eliminated many of its tariff and non-tariff barriers on grain imports except import licenses for

For More Information

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corn, wheat, and barley. NAFTA-induced economic growth, however, could have a sizeable impact on U.S. exports of food grains like wheat to Mexico. Also, increased Mexican demand for meat would stimulate Mexican livestock feeding and import demand for U.S. sorghum and other feedgrains.

Livestock and Meat. NAFTA would have only a small effect on the relatively unrestricted U.S. imports of Mexican feeder cattle. In fact, Mexican feeder cattle exports to the United States will likely decline in the near term as Mexico rebuilds a depleted cattle herd. Any growth in Mexican meat demand stimulated by NAFTA will provide incentives for both additional Mexican imports of U.S. meat and the diversion of Mexican feeder cattle exports into domestic meat markets. The final outcome will depend on the growth rate in Mexican meat demand and the way in which Mexican cattle and hog producers respond to the current decapitalization in their industries. Schulthies and Williams argue that Mexico will likely continue to specialize in feeder cattle production and export, while the United States will continue to export meat, breeding stock, and genetic material. Fat cattle trade in either direction will not likely amount to much.

Dairy Products. Mexico has also substantially reduced dairy product import barriers. The main NAFTA impact on U.S. dairy exports will be through the food demand expansion effects of Mexican economic growth stimulated by the agreement. Of course, prospective changes in U.S. milk production are also important considerations. Substantial herd rebuilding has occurred in Mexico since 1987, making long-term trade prospects uncertain. An increase in Mexican incomes would likely shift the composition of Mexican dairy product demand away from low-quality basic products such as non-fat dry milk and filled cheeses to fluid milk and specialty products like ice cream and fine cheeses. If Mexican per capita milk consumption reached U.S. levels by the year 2000 and Mexican milk production continues to grow at the annual growth rate over the last 30 years (5 percent per year) through the end of this decade, annual Mexican consumption will far outstrip production.

Cotton. For cotton, changes of trade rules appear somewhat more favorable to Mexican rather than U.S. exporters. However, growth in Mexican incomes and a related increase in the production of textiles and apparel for domestic and export sale, will likely mean that cotton will continue to flow from the United States to Mexico despite NAFTA.

Sugar. The proposed NAFTA would open U.S. markets to imports of Mexican sugar, particularly if Mexico becomes a net exporter of sugar—a questionable possibility. If Mexico converted its soft drink industry to high fructose corn syrup (HFCS), then 500,000 mt of raw sugar could be freed up annually for export to the United States. This assumes, however, that HFCS can compete with raw sugar in Mexico, and that an economic incentive exists to ship sugar to the United States. Mexico has exported raw sugar to the United States in only one of the last three years and does not currently appear to have a clear advantage in sugar production and exporting.



In Mexico as incomes have improved, large grocery stores have increasingly replaced traditional open markets.



Gary W. Williams

Processed Products. U.S. processed food exports to Mexico have increased in recent years. Even so, many U.S. firms are opting to make direct investments in Mexico. Recent changes in Mexican investment laws make it easier for U.S. companies to own Mexican businesses and land. These changes have led to a sharp increase in foreign direct investment (FDI) in the Mexican economy. However, FDI in Mexican agricultural production still only accounts for about 0.1 percent of overall FDI in Mexico, and FDI in the food processing sector is only 1.8 percent of overall FDI in Mexico. NAFTA will provide additional incentive for the direct investment strategy.

Some people are concerned about U.S. firms relocating their operations to Mexico to lower costs with the intention of shipping their products back to the United States for sale. This does not seem to be the case for food products, however. With some exceptions, sales of U.S. food processor affiliates in Mexico are directed primarily to local rather than U.S. markets. Handy argues that U.S. food processing firms investing in Mexico are more concerned about Mexico as a potential market for their products rather than using these investments as a "platform" for export sales back to the United States.

Thus, comparatively little remains for NAFTA to liberalize because of unilateral Mexican trade liberalization and other Mexican economic reforms over the last few years. This means that little additional growth in trade of most agricultural commodities between the two countries can be expected directly from NAFTA. Continued growth in U.S.-Mexico agricultural trade will depend primarily on the pace of overall economic and per capita income growth in Mexico as the result of continued economic reform and capital investments in productive activities in Mexico. NAFTA will be instrumental in facilitating and institutionalizing that process. C