



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

AGRICULTURAL TRADE LIBERALIZATION-- IMPACTS ON CONSUMERS

Jean Kinsey
University of Minnesota

Trade liberalization benefits consumers because it gives them access to a larger number and a wider variety of products, at lower prices, than their home country could supply. The principals of comparative advantage and specialization are well known. They have been used extensively by economists to argue for free trade across international borders. Any third-year economics student can show you that when two countries export goods that they are more efficient in producing, and import goods which they are less efficient at producing, the welfare (standard of living) of their consumers rises. This increase in welfare is typically illustrated by some measure of consumer surplus that results from lower prices and higher consumption. For example, in a study of consumer benefits from the Canada-U.S. Free Trade Agreement (CUSTA), it was found that consumers in each country gained nearly \$1 billion (Tweeten et al.). This improvement in welfare is *prima facie* evidence that trade liberalization is good for consumers.

This could be the end of the story if it were not for the fact that international trade in agricultural products, though far more liberalized than 20 years ago, is still being negotiated in multilateral agreements and trade flows can be, and often are, trumped by other political and economic events. One of these is the increased volume and value of trade in processed foods relative to agricultural commodities. On a world-wide basis, trade in processed foods has exceeded that of agricultural commodities since the 1970s and is growing at an annual rate of 9.5 per-

cent (Henderson et al.). Figure 1 relates that processed food's share of global agricultural trade rose from 58 percent in 1972 to 67 percent by 1993. Figure 2 shows the percent of total agricultural trade (imports plus exports) that was in bulk commodities, intermediate goods and consumer goods from 1993 to 1997. Intermediate and consumer goods combined was over 60 percent in all years. Related to this is the globalization of markets for goods and services that appear to operate outside of, or in spite of, trade agreements. Another issue is a set of new non-tariff barriers that are not transparent and sometimes not even intentional, but nevertheless they restrict the flow of products and the sale of imported goods. Lastly, liberalized trade of currencies in a flexible exchange regime where rising currency values (as in the United States) and rapid devaluations (as in Asia and Mexico) can swamp the effects of trade negotiations on consumer welfare.

Less Trade in Bulk Commodities

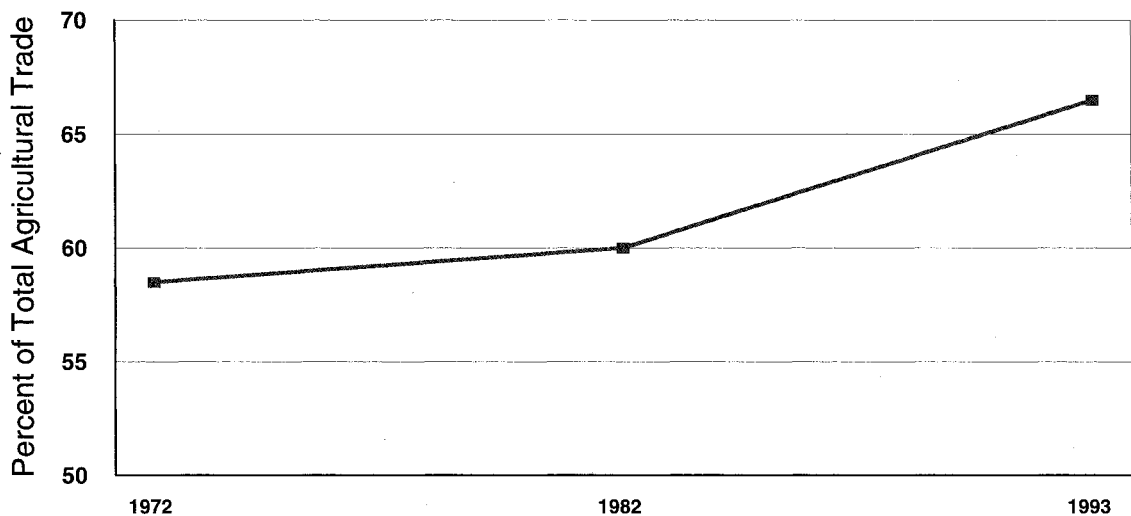
The diminishing relative importance of trade in agricultural (bulk) commodities has the effect of diminishing the dominance of the economic trade model articulated at the beginning of this paper and changes the way we think about the benefits of international trade. The comparative advantage model works well for bulky, homogeneous commodities over which government policy has some control. It does not serve well to explain trade that is intra-industry as well as international. In the food processing sector, the same company is often located

in several countries and each country simultaneously imports and exports similar goods. Global competition depends not on the resource base of a country as much as on the competitive efficiencies of a particular company, regardless of its location. Alternative economic models involving imperfect competition, game theory and other hypotheses that deal

with product differentiation, locational advantages, and internationalization of gains are needed.

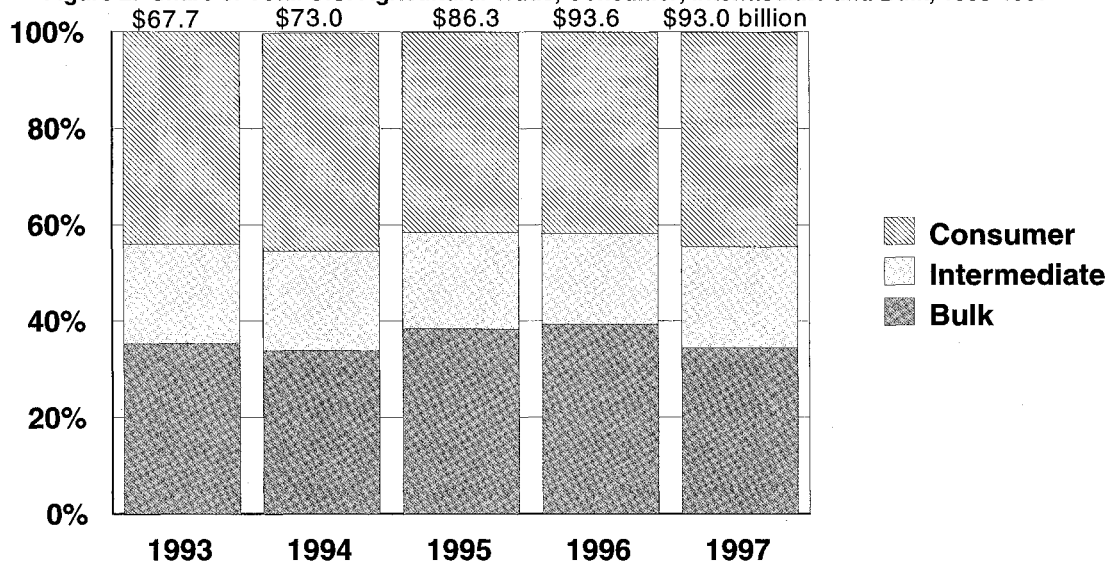
Trade agreements between nations are themselves less binding because smart and aggressive companies can find ways to circumvent the rules or to comply with the regulations in order to export

Figure 1. World Trade in Processed Foods (1972, 1982, 1993)



Source: USDA/FAS

Figure 2. Share of Total U.S. Agricultural Trade, Consumer, Intermediate and Bulk, 1993-1997



Source: USDA/FAS

products, technology or capital. An example of entrepreneurial exporting is the increased processing of fresh commodities like avocados into foods like guacamole in Mexico before they cross the border to the United States. Since fresh avocados face entry restrictions on phytosanitary grounds due to seed weevils and other pests, and manufactured products face only a tariff that is declining to zero by 2003, processing in Mexico has grown in popularity.

Even with the tariff, it is often profitable to sell finished food products in the United States since American consumers are willing to pay for variety, convenience and safety in their market basket. If the mark-up on the product is high enough, the compliance costs are borne by the consumers in the importing country. Another example of foreign manufacturing of food products prior to exporting to the United States is Canada's export of prepared foods such as microwaveable meals that contain poultry. Poultry meat in this form is not subject to tariff rate quotas faced by the poultry meat alone. The value of imported ready-to-eat poultry entrees from Canada rose 12 percent in the first five months of 1996 (USDA 1996b).

As a result of this type of trade, consumers benefit from a greater variety of foods spurred, in part, by marketplace rivalry and innovation. Prices on the manufactured, convenience foods are lower than they would otherwise be due to the competitive advantage of manufacturing firms regardless of the comparative advantage of an exporting nation. With competition from imported food products and/or local affiliates of foreign food manufacturing companies, domestic food manufacturers respond to this competition with increased efficiencies. Evidence of this lies in the labor productivity of the U.S. food processing sector. It is 30 percent greater than in other U.S. manufacturing firms (Henderson et al.).

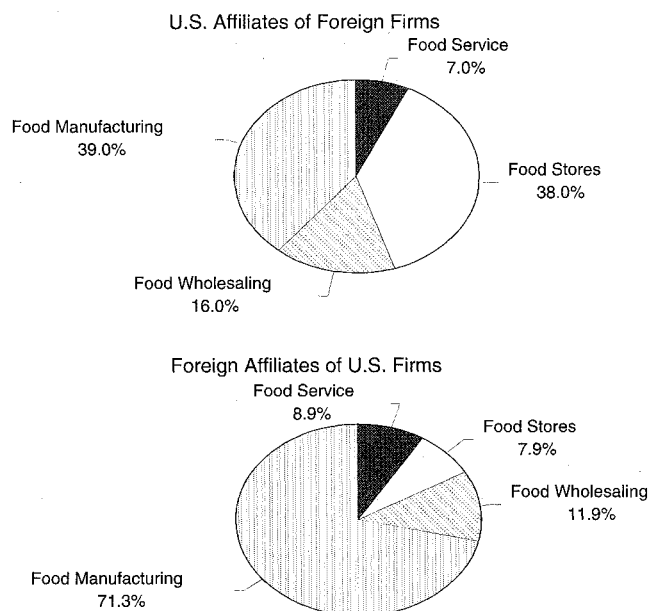
Intra-Industry Trade: Direct Foreign Investment

Globalization of the food industry goes beyond trade in processed food. Increasingly, U.S. food companies are locating processing plants or distribution centers in foreign countries, or buying out foreign companies in order to increase sales outside the United States. Companies headquartered in the United States had \$162 billion in sales out of foreign affiliates in 1996; 71 percent of that was in the food manufacturing sector (Figure 3 (Gallo)). Over 50 percent of the investment in food manufacturing plants on foreign soil was in Europe (USDA 1996a). Sales of processed foods from these foreign affiliates is over 4 times the value of product exports from U.S.-based companies, and almost 80 percent of those sales are into the country where the affiliate is located. Only two percent of the sales of affiliates came back to the United States (Henderson et al., p. 78,81).

Food stores and restaurants combined had 17 percent of foreign affiliate sales, with restaurants making up the bulk of those sales. The two largest fast food restaurants in the United States, McDonald's and Kentucky Fried Chicken, have 43 and 53 percent of their sales, respectively, in foreign countries. United States' exports have exceeded imports in this sector since 1991, with a positive trade balance of \$4.6 billion in 1995 and \$2.3 billion in 1996.

Likewise, foreign-owned food companies are buying up U.S. food companies at all levels of the food chain (farms to retail stores to restaurants), and selling products locally and around the world. Sales from affiliates of foreign-owned food firms located in the United States was \$152 billion in 1996, with 39 percent of this amount in the food manufacturing sector. More interesting is an almost equal amount of sales in the retail food (supermarket) sector. Direct foreign investment in retail stores by European companies has been aggressive in the U.S. with Ahlud from the Neth

Figure 3. Food Sales from Foreign Affiliates



Source: USDA 1996a

erlands (Mayfair, Giant, Tops, BI-LO and others), Sainsbury from the UK (Shaw's), Theo Albrecht from Germany (Albertson's), Tengelmann, AG from Germany (A&P Tea Co.), Delhaize and Le Lion from Belgium (Food Lion) being the largest foreign retail investors.

While retail stores account for 42 percent of foreign-owned affiliates sales in the United States, sales from retail stores owned by U.S. companies in other countries account for only 9 percent of total foreign affiliate sales of U.S. food companies (Henderson et al., p. 69). The largest foreign-owned fast food restaurant, Burger King, owned by Diagio in the UK, sells 80 percent of its products in the U.S. (Henderson et al., p. 95). Globalization, in the sense of multinational operations and ownership, is much more prevalent among U.S. food manufacturers and U.S. food service establishments than retail stores. Direct investment in the United States by foreign-owned companies is more prevalent in the retail (supermarket) business. Foreign affiliates

of multinational companies bring variety, quality and assurances of a standard product to consumers in each of the countries where they operate. Competition among them, and with local food sellers, helps keep food prices relatively low.

Non-Tariff Trade Barriers: Human Health and Safety

Trade negotiations that affect the sale of food products tend to be focused on technical standards and regulations about quality and safety that impact human health. Traditional trade barriers such as quotas, tariffs or phytosanitary concerns tend to be focused on protecting markets for domestic farmers and keeping the environment free of pests and diseases that would hurt farm production. They are still important for that purpose, but rising in importance are regulations that are designed to protect consumers from short- and long-run diseases borne by food products.

Curtailling micro organisms and pathogens that cause immediate illness, and diminishing the fear of long-term chronic disease from pesticides and untested technologies is relatively new at the negotiating table. Standards and regulations can be challenged as “unwarranted” non-tariff trade barriers if it cannot be shown that they are based on scientific evidence or sound risk assessment. The World Trade Organization (WTO) is the primary arbiter of such trade disputes.

A given country may lay down a rule that food being manufactured with a certain process, like using irradiation or non-pasteurized milk, is unsafe for their consumers but they cannot do this if the regulation does not also apply to their domestic manufacturers. This would be a discriminatory trade regulation and, as such, would be deemed illegal by the WTO.

The real sticking point in negotiating claims of unwarranted trade barriers of food products is the criteria for scientifically-sound evidence that a product is unsafe. The science itself produces uneven results and whether or not a food is safe depends more on local consumers’ willingness to take the risk (however small) of a future illness than on a sound scientific principle. Complicating this is the fact that what is risky in one country may not be so risky in another. For example, in France, sulphur dioxide is used to preserve wine—French people drink a considerable amount of wine. It seems reasonable to restrict the amount of sulphur dioxide in the food in France since the cumulative effect in the French diet could be harmful. In countries where little wine is consumed, this need not be a concern (Kinsey).

Europeans have a more conservative attitude towards food produced with new and untested technologies like bovine growth hormones and genetic engineering than do Americans. On the other hand, they have considerable more faith in the reputation of foods from particular regions where a history of production

techniques assures high quality and safety—even though they would not meet international scientific standards.

Two methods of regulating technical standards are harmonization and equivalence (mutual recognition). Both intend to protect consumers, but they are not always compatible. It has been suggested that for food trade, mutual recognition of processing methods is appropriate for quality standards while harmonization should be used for safety standards (Hooker and Caswell). Harmonization may have greater value for bulk or intermediate goods, but it could lead to less variety for consumers if applied to final food products. Agreeing on a processing standard has been the preferred method in the United States—it is less expensive than inspecting random samples of the final product. The Europeans, however, tend to favor testing the final product since it allows for the more diverse regional products and traditions so beloved in much of Europe. Consumers generally do not care which method is used as long as the final food offerings are high quality, safe and diverse.

Reinforcing the importance of trade agreements like NAFTA is a new private organization called the North American Alliance (NAA). It was created in May, 1998, for the purpose of further reducing trade barriers for food and consumer products in NAFTA countries. This organization is comprised of the major trade associations of food manufacturers in Mexico (ConMexico), Canada (Consumer Products Manufacturers of Canada) and the United States (Grocery Manufacturers of America). They are engaging in significant trade dialogues to encourage government acceptance of their industry’s suggestions on free trade. One can expect further harmonization of standards for products, labeling and packaging, and increased movement of products across borders with this kind of lobbying effort by the industry.

Does NAFTA Benefit Consumers?

What difference has NAFTA made to consumers in the United States? An academic study estimated that imports were 14 percent higher in 1994 and 20 percent higher in 1995 than they would have been without NAFTA. NAFTA also helped prevent a 54 percent fall in exports that would have occurred in its absence after the 1994 devaluation of the peso (de Janvry and Sadoulet). In contrast, the Economic Research Service of USDA estimated that only 3-5 percent of the increase in trade with Mexico and Canada is attributable to the provisions in NAFTA (USDA 1997). Mexican trade had very little impact on jobs in the United States because their imports are not good substitutes for domestically-produced goods. Many of the imports from Mexico are manufactured versions of intermediate foods, formerly exported from the United States and sent back home ready-to-eat. In this way, demand for imports generated more demand for U.S. exports.

Part of the NAFTA agreements relate to food safety, labor laws and environmental protection. It is unclear whether Mexican produce contains more pesticides. Testing of final products has not shown this to be so. Also, some studies found that horticultural production under NAFTA used less chemical-intensive methods than production in Florida (Abler and Peck). With the heavy emphasis on manufactured food products, it is likely that food safety issues will be confined to fresh fruits and vegetables that can be readily contaminated by handlers and water supplies.

The concern of consumers and health officials about contaminated fresh products from a number of countries where water and sanitation are less than adequate is real and growing. It is one of the negative effects of globalization in food trade, and one which is difficult to control—short of banning suspicious produce from particular locations. Again, competitive forces faced by the owners or contractors of the pro-

duction facilities are one of the best assurances of clean food. The primary watchdog becomes the handlers' and distributors' programs of hazard analysis and critical control points (HACCP) rather than a government inspector. Consumer demand for assurances of safety is the best protection they can have. Consumers in affluent countries, with high wages and tight time schedules, are not going to repeat a purchase of food that makes them ill, loses them time on the job, costs them clients or ruins a vacation trip. They demand to be protected either by their governments' enforcement of safety regulations or by the companies from which they purchase food. Competition for the business of the consumer goes a long way towards ensuring quality and safety, with government regulations serving as a safety net.

Trade in Currency

Trade liberalization extends to capital markets. These markets are more volatile and have been known to cause more disruption of trade flows than any tariff or non-tariff trade barrier. Over-valuation of currency is deflationary and tends to diminish exports that become too expensive for other countries. It favors domestic consumers with lower prices. The U.S. dollar has been very strong relative to other world currencies and is one factor contributing to our high consumption and low inflationary environment.

Countries with weak currencies often trade it for stronger currencies. This move further devalues the country's own currency, but leads to export demand for its relatively cheap products. In South Korea, Thailand and Indonesia, the volume of exports has risen 20-30 percent over the past year since their currencies devalued. The same was true in Mexico after their 1994 devaluation. As the prices of these exports fall, the importing countries' consumers benefit (*The Economist*, 8/29/98, p. 64). Devaluation acts as an export subsidy and as an import tax. It reduces the import

volume and boosts domestic prices. It is unfavorable to domestic consumers, and it is inflationary.

Currency values have fluctuated wildly in emerging nations in recent times, partly because foreign speculators—mostly from the United States and Europe—invested large amounts of cash in promising new businesses. When this foreign cash was withdrawn at the first sign of weakness, often accompanied by defaulting bank loans, the currencies collapsed. Interest rates rose dramatically, decreasing the demand for borrowing and investment. For example, the devaluation of the Mexican peso in 1994 was precipitated by Mexico's reliance on short-term speculative capital inflows. When this foreign capital flowed out, there was insufficient domestic savings to cover the losses and the devalued peso.

Currently, a widespread devaluation of foreign currencies—starting in Asia, then in Russia and now in South America—has led to cheaper imported goods for U.S. consumers. This happens in spite of any trade negotiations or agreements. On the other hand, it has raised the price of our exports, and companies that sell much of their product abroad have had to lay off workers which, of course, hurts consumers' income. Agriculture is one sector that relies heavily on exports to these countries, and the demand for its exports and its prices are down. In fact, *The Economist's* all-commodity price index has fallen 30 percent since 1997 and is the lowest, in real terms, in over 25 years (*The Economist*, 9/5/98, p. 19).

Studies have shown that having trade agreements on goods and services in place when a devaluation occurs cushions the fall in exports from the United States and other strong economies (de Janvry and Sadoulet). In terms of U.S. consumers, low trade barriers facilitate a continued flow of cheaper imports than would have otherwise been the case. On the whole, consumers benefit from liberalized trade. They have

access to a larger variety of goods and services, the prices are generally lower, and competition among sellers is more responsive to their preferences.

References

- Abler, D. and Pick d. "NAFTA. Agriculture and the Environment in Mexico," *American Journal of Agricultural Economics*. 75(August 1993): 794-798.
- de Janvry, Alain and Elisabeth Sadoulet, *NAFTA and Agriculture: An Early Assessment*. Working Paper No 807, revised. Berkeley CA: University of California-Berkeley, Department of Agricultural and Resource Economics, January 1997.
- Gallo, Tony. *The Food Marketing System in 1996*. Agriculture Information Bulletin No. 743. Washington DC: U.S. Department of Agriculture/Economic Research Service, July 1998.
- Henderson, Dennis R., Charles Handy and Steven A. Neff eds. *Globalization of the Processed Food Market*, Agricultural Economic Report No. 742. Washington DC: U.S. Department of Agriculture/Economic Research Service, September 1996.
- Hooker, Neil H. and Julie A. Caswell. "Changes in Diversification Among Very Large Food Manufacturing Firms in the 1980s." *Agribusiness: An International Journal* 10(5).
- Kinsey, Jean. "GATT and the Economics of Food Safety," *Food Policy*. April 1993, p. 163-176.
- The Economist*. "Better News in Asia." August 29, 1998, p. 64.
- The Economist*. "On the Edge." September 5, 1998, pp. 19-21.
- Tweeten, Luther, Jerry Sharples and Linda Evers-Smith. *Impact of CFTA/NAFTA on U.S. and Canadian Agriculture*. Working Paper 97-3. Columbus OH: International Agricultural Trade Research Consortium, March 1997.
- United State Department of Agriculture. *Food Marketing Review, 1994-1995*. Agricultural Economic Report No. 743. Washington D.C.: U.S. Department of Agriculture/Economic Research Service, 1996a.
- United State Department of Agriculture. *NAFTA. International Agriculture and Trade Reports, Situation and Outlook Series*. WRS-96-3. Washington DC: U.S. Department of Agriculture/Economic Research Service, September 1996b.
- United State Department of Agriculture. "NAFTA's Impact on U.S. Agriculture: The First 3 Years," *Agricultural Outlook*. Washington DC: U.S. Department of Agriculture/Economic Research Service, September 1997, p. 20-23.