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THE NAFTA NEARS FULL IMPLEMENTATION—WHAT DOES THIS MEAN FOR THE U.S. DAIRY INDUSTRY?

Developments under the North American Free Trade Agreement (NAFTA) have important implications for the U.S. dairy industry. Implementation of the NAFTA began in 1994 and will be completed in 2008. Much of the NAFTA is structured as three separate bilateral free trade agreements (FTAs), one between the U.S and Mexico, a second between the U.S. and Canada (subsumed under the NAFTA), and a third between Canada and Mexico. The focus here is on the U.S.-Mexico component of the three-nation agreement, since Canada excluded its dairy trade provisions from reform under the NAFTA.

The NAFTA already has reduced Mexico's tariff to zero on certain U.S. dairy products. For example, Mexico's tariffs on U.S. fluid milk and cheese fell to zero in 2003. This made U.S. cheese, in particular, more competitive since Mexico's tariffs on cheese imported from third countries remained at about 20 percent in 2003.

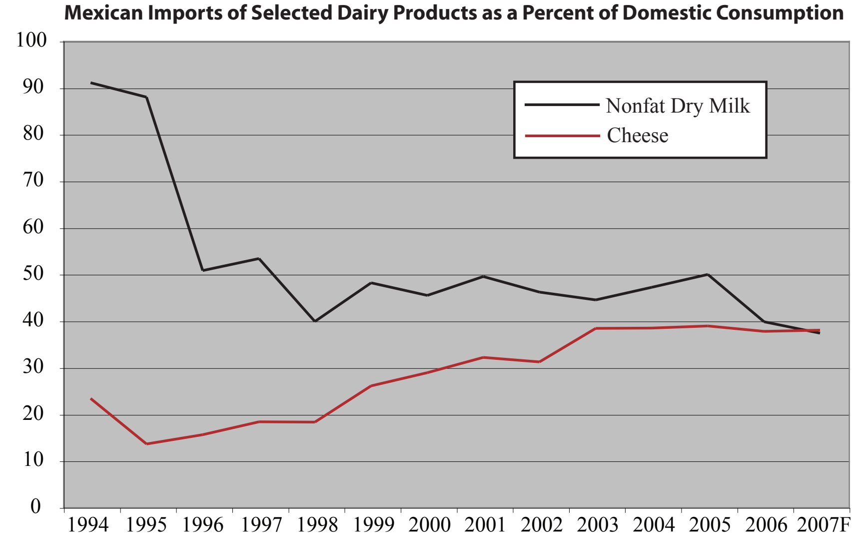
Under the NAFTA, Mexico agreed to reduce tariffs on U.S. nonfat dry milk (NDM) imports over a 15-year period ending in 2008. In 1994, Mexico had authorization under the NAFTA to levy a 139 percent tariff on NDM imports from the U.S. exceeding 40,000 MT (over quota amount). In 2008 when the NAFTA is fully implemented, the tariff is scheduled to fall to zero for all U.S. NDM imported by Mexico.

U.S. dairy exports to Mexico generally rose during the NAFTA implementation period. For example, from 1997 to 2006 the yearly value of U.S. exports of dairy products to Mexico increased by 154 percent. Mexico's imports of U.S. dairy products were valued at $438 million in 2006 (23 percent of the total), making that country the largest destination market in value terms for U.S. dairy products. Obviously, not all the increases in Mexico's imports of U.S. dairy exports can be attributed to the NAFTA. Exchange rate movements, increased demand for NDM in Mexico associated with expanded government feeding programs, growth of consumer incomes in Mexico, and the NAFTA all contributed to Mexico's generally increasing imports of U.S. dairy products.

Mexico's dairy industry has adjusted to conditions prevailing during the NAFTA implementation period. A big adjustment was the increase in Mexico's self-sufficiency level for NDM. Mexico's imports of NDM as a percent of consumption fell from about 90 percent in 1994 and 1995 to 40 to 50 percent in the mid-2000s. This contrasts to the figures for cheese, where Mexico's self-sufficiency level fell from 1994 to the mid-2000s.

Overall, Mexico's production of dairy products remains substantially short of self-sufficiency, which augurs well for continued large U.S. dairy exports to Mexico. However, Mexico's dairy market no longer represents "low hanging fruit" for U.S. dairy exporters. Competition for sales of dairy products in Mexico's mature dairy market is keen, especially for commodities.

Mexican Imports of Selected Dairy Products as a Percent of Domestic Consumption



Sources: USDA-FAS, "Dairy: World Markets and Trade," Various Issues, 1998–2006. *F=Forecast.

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