

North American Free Trade and U.S. Agriculture

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The use of trade agreements to achieve both domestic and international trade policy objectives is increasing. As a result, some U.S. producers have experienced more market access and rising exports for their products, while others have faced more import competition and lower prices. Along with new trade opportunities, producers can expect more risk, such as the 1995 Mexican peso devaluation. This leaflet provides a long-term view of U.S.-Mexico trade and the implications of the North American Free Trade Agreement (NAFTA).

NAFTA, negotiated between the United States, Canada and Mexico, was implemented on January 1, 1994. It created one of the world's largest free trade areas. The three member countries have a combined population of 385 million people, \$8.5 trillion in annual economic output, and annual trade exceeding \$2.0 trillion.

NAFTA is designed to expand the flow of goods, services and investment throughout North America by (1) the full, phased elimination of import tariffs and (2) the elimination or fullest possible reduction of nontariff trade barriers, such as import quotas, licensing schemes, and technical barriers to trade. Trade restrictions applied by the three countries to imports from all other countries will remain in effect unless modified through World Trade Organization (WTO) negotiation or other trade agreement. In agricultural trade, NAFTA contains two separate bilateral agreements, one between the United States and Mexico and another between Mexico and Canada.

Potential for Agricultural Trade

NAFTA builds on previous reductions in Mexican trade barriers. Mexico became a member of GATT in 1986 and tariffs on many U.S. exports were reduced from as much 100 percent to 10 to 20 percent before NAFTA. Lower tariffs, coupled with stronger economic growth in Mexico, led to an upsurge in trade.

Mexico has become the third largest market for U.S. agricultural exports, purchasing food and fiber valued at \$5.4 billion in 1996. Major U.S. agricultural exports to Mexico include grains, meats and livestock products, fruits, nuts, vegetables and other horticultural products. Exports of beef, poultry, pork, corn, and soft fruits increased during 1994, NAFTA's first year (Fig. 1).

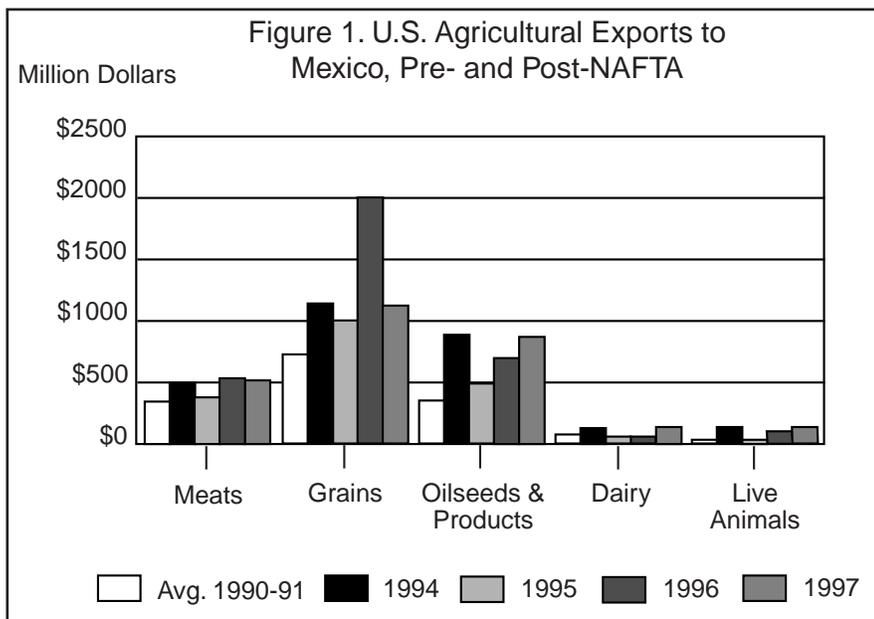
The sharp devaluation of the Mexican peso reduced short-term export opportunities. U.S. exports of most food products declined 25 to 35 percent because the prices of most U.S. goods nearly doubled. U.S. imports of Mexican products surged as the peso's value dropped. For example, tomato imports increased 60 percent in 1 year and most other vegetable exports to the U.S. also increased. Mexican economic recovery was rapid, with U.S. agricultural exports setting a new record in 1996.

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Figure 1. U.S. Agricultural Exports to Mexico, Pre- and Post-NAFTA



With a growing population, more two-income families, and diversification of diets, Mexico is poised to become a major market for U.S. food and fiber. An estimated 84 percent of Mexico's 93 million people have per capita incomes below \$865 per year, severely limiting consumer demand. Market potential is also limited by underemployment, slow economic development, and lack of improvement in the efficiency of transportation, storage and handling infrastructure.

U.S. agricultural imports from Mexico were valued at \$3.8 billion in 1996, up 31 percent since 1994. Major imports were vegetables, live animals (mainly feeder cattle), coffee, fruits, nuts and malt beverages. Competitive imports have increased since NAFTA was implemented, accounting for 81 percent of total agricultural imports from Mexico and leading to more competition for some U.S. producers.

Impacts on Selected Commodities

NAFTA is expected to have a positive overall impact on U.S. agriculture. The USDA estimates that U.S. agricultural exports to Mexico could increase by \$2 billion per year after NAFTA is fully implemented. Gains in grains, meats, poultry and cotton are likely to offset losses expected in the fruit and vegetable sectors. Most changes will be small because of the long length of the transition period and the relatively low level of many pre-NAFTA duties.

Benefits to the United States will arise as exports increase, creating additional business activity and more jobs. Costs will be incurred in both countries when domestic production is supplanted by imports and jobs are lost.

Increased U.S. export demand will raise U.S. prices, unless there is a corresponding increase in supply. Consumers of some products will be worse off if higher prices are passed on to them. More imports increase the supply available to consumers and prices will drop, unless domestic suppliers reduce production in the face of these lower prices. The net benefits from trade depend on the balance between trade gains and losses and the resulting impacts on prices, jobs, income, taxes and social costs.

Beef and Cattle. Mexican duties of 20 percent on fresh and chilled beef, and 15 percent on live cattle, were eliminated on

January 1, 1994. U.S. exports of beef were up 84 percent in 1994, to 72,000 tons. The Mexican market represents about 5 percent of all U.S. beef exports. Exports declined to 29,000 tons in 1995 because of the devaluation of the Mexican peso, but recovered to 59,000 tons in 1996. Mexican demand for imported beef could reach 200,000 metric tons by the year 2004. Over the long term, NAFTA will have a positive impact on U.S. beef producers as more meat and fed steers are exported to Mexico.

Higher prices for beef and beef by-products will have a small positive impact on cattle prices, on balance. These changes will be small because U.S.-Mexico livestock and meat trade is largely complementary, with the U.S. exporting meat and meat products and Mexico exporting live cattle. Meat exports boost beef and cattle prices but imports of feeder steers reduce them.

U.S. imports of Mexican feeder and stocker cattle have expanded from 500,000 head in 1980 to 1.2 million head in 1994 and a record 1.6 million head in 1995. Only 431,000 head were imported in 1996, compared to 650,000 head in 1997. Constraints to increased cattle imports are limitations on herd size due to drought and herd liquidation, undesirable breed characteristics, increased demand for meat in Mexico, and compliance with some U.S. animal health regulations.

Poultry. U.S. poultry exports to Mexico have quadrupled from 51,000 tons in 1990 to 237,000 tons in 1996. Mexican imports account for 8 percent of total U.S. poultry exports. About 55 percent of these exports are broilers and 34 percent are turkeys. U.S. exports are expected to continue to increase as trade barriers are lowered and economic development proceeds. Moderate

gains in U.S. employment should occur as poultry output increases, mainly in the processing and service sectors, because growers can add capacity without much additional labor.

Feed Grains. A 15 percent seasonal tariff on grain sorghum was eliminated on January 1, 1994. Corn trade is being liberalized more slowly due to its political and social importance in Mexico. Under a tariff-rate quota, a minimum of 2.8 million tons of corn may now enter Mexico duty free each year. The quota was exceeded by more than 3.0 million tons in 1996 due to drought in Mexico and a short crop. The duty-free quota will grow 3 percent annually, and the 180.6 percent duty on over-quota corn imports will be eliminated over 15 years. During 1996, 6.3 million tons of corn and 2.0 million tons of grain sorghum were exported to Mexico. Mexican demand for U.S. feed grains has increased as more grains are fed to cattle, hogs and poultry. However, supply and demand conditions in the rest of the world are the dominant factors affecting U.S. prices.

Wheat. U.S. wheat exports have expanded from 321,000 tons in 1990 to 1.5 million tons in 1996. NAFTA will result in gains for input suppliers and grain elevators as trade volume expands. Intense competition from Canada has curtailed U.S. export growth in recent years. Price impacts will be small because U.S. wheat prices are determined by many global factors.

Rice. Exports to Mexico should expand moderately as Mexico lowers its current 10 percent duty on rough rice and a 20 percent duty on milled rice. Both duties will be phased out over 10 years. U.S. rice exports have increased since 1990, to 390,000 tons in 1996. This represents about 10 percent of total U.S. exports.

Cotton. U.S. cotton producers should benefit from increased exports and slightly higher prices as Mexico's 10 percent duty is reduced over 10 years. Since 1990, U.S. cotton exports to Mexico have expanded from 204,500 bales to 689,000 bales in 1996. Mexico will gain greater access to the U.S. market as the Section 22 quota is replaced by a tariff-rate quota. U.S. cotton imports from Mexico reached 47,000 bales in 1996, up from almost nil in 1990.

Peanuts. NAFTA was projected to have a small positive impact on U.S. peanut producers. A stronger Mexican peso, coupled with more production, reduced U.S. peanut exports to 4,500 tons in 1996. U.S. exports can be expected to increase moderately to about 25,000 tons. The U.S. will use a tariff-rate quota to limit shipments from Mexico. NAFTA provisions allow only Mexican grown peanuts to be processed

into peanut butter and paste for low duty shipment to the U.S. market. However, it is also likely that higher consumer incomes in Mexico will lead to increased demand for U.S. grown raw peanuts, resulting in additional exports.

Fruits and Vegetables. NAFTA is expected to have mixed impacts on the U.S. fruit and vegetable industry. U.S. imports of Mexican products such as broccoli, cucumbers, melons and onions, which have been protected by high duties (17 to 35 percent ad valorem), will increase. U.S. fresh and frozen vegetable imports increased 32 percent, from 1.4 million metric tons in 1994 to 2.1 million tons in 1996. Tomato imports increased to 686,000 tons, carrot imports doubled to 35,000 tons, cauliflower was up 28 percent to 200,000 tons, lettuce imports increased four-fold to 10,000 tons, squash was up 10 percent to 135,000 tons, and pepper imports were up 28 percent to 249,000 tons.

Because of the low level of protection prior to NAFTA and the long phase-out period, it is expected that NAFTA will have only a slightly negative impact on U.S. citrus producers. In fact, as the Mexican economy expands, it is possible that U.S. fresh orange exports to Mexico will increase.

Additional imports have led to increased concerns about food safety and the presence of chemical residues on fresh products, even though imports must meet U.S. food safety standards. Higher import volumes are likely to lead to increased concerns about imported animal and plant diseases and pests. Taxpayer costs to monitor and inspect more imported food from Mexico will increase.

Dairy Products. Under NAFTA, there is the potential for more commercial exports of milk powder and evaporated milk to Mexico. During 1996 nonfat dried milk exports to Mexico were 5,000 tons, down from 34,000 tons in 1994. Evaporated and condensed milk exports increased from 1,500 tons to 30,000 during the same period, however. In the past, Mexico has imported large quantities of subsidized dairy products from the U.S. In the short run, it is likely that U.S. government export programs will continue to be an important factor affecting the level of Mexican dairy imports.

U.S. cheese producers will probably benefit from NAFTA because the Mexican cheese import licensing scheme will be replaced with a 20 percent tariff to be eliminated over 10 years. This will open a larger market for U.S. cheese and cheese products. U.S. cheese exports have grown from 1,000 tons in 1990 to more than 4,732 tons in 1996.

Lower Mexican tariffs on fluid milk, which will decline from 10 percent to zero over 10 years, will create a larger market for U.S. products, resulting in expanded export demand and higher producer prices. Fluid milk processors will gain from greater demand for fluid milk and added access to the Mexican market. U.S. consumers may face slightly higher milk prices in some areas.

Sugar. The U.S. and Mexico will phase out trade barriers in sugar over a 15-year period. For exports to exceed the current quota level of 7,258 metric tons, each country will have to become a net surplus sugar producer. Both countries import sugar. In recent years, Mexico has imported up to 1.4 million tons of sugar, with the United States supplying 20 to 25 percent of the Mexican import market, mostly under the sugar re-export program. If the United States becomes a surplus producer, exports to Mexico can expand to a maximum of 250,000 metric tons per year, duty free. Over-quota duties of \$.16 per pound on Mexican imports will be reduced and eventually eliminated. In 1996 U.S. sugar exports to Mexico were 27,528 tons, down 14 percent from 1995 and nearly equal to those of 1994. U.S. imports of Mexican sugar were 42,448 in 1996, more than double 1995 levels.

Both U.S. and Mexican duties on high fructose corn syrup (6 to 15 percent) will be phased out on a straight line basis over 10 years. This should allow U.S. agribusinesses to export additional HFCS to Mexico as per capita incomes in Mexico increase and import demand for sweeteners expands. Although there are seven wet millers of corn in Mexico, it appears unlikely that capacity exists to keep pace with projected HFCS demand without additional investment in infrastructure and increased corn production. In 1997, Mexico imposed anti-dumping duties on imports of U.S. HFCS.

Processed Food Products. U.S. exports of processed food products to Mexico have expanded in recent years. Consumer-ready food product exports to Mexico surpassed intermediate

product exports in 1991-1993. Changing Mexican life-styles, such as more two-income families, will increase consumer demand for more conveniently packaged and prepared food products. Since 1990, for example, U.S. exports of snacks, breakfast foods, and processed fruits and vegetables have more than doubled. Other items associated with higher income levels—wine and beer, tree nuts, nursery products, cut flowers, pet foods—also have more than doubled. Continued income growth and economic expansion in Mexico are keys to export market strength.

Conclusion

NAFTA created one of the world's largest free trade areas. It is designed to boost trade and economic growth, and lead to increased employment in all three countries. Trade gains, however, will not be made without some costs, as labor intensive agricultural sectors face more competition from imports and must adjust. Overall, U.S. agriculture stands to gain more than it will lose as trade barriers are lowered. Livestock, meats, feed grains, dairy, cotton, soft fruits, and processed foods are examples of U.S. sectors that will benefit. Some labor intensive fruit and vegetable producers have been adversely affected by NAFTA and are adjusting to the impacts. However, even the fruit and vegetable industry will see some benefits over the longer term as stronger economic growth in Mexico increases demand for many products. Finally, NAFTA secures previous gains to trade that have already benefitted many sectors of U.S. agriculture.

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This publication was contributed by the *Southern Extension International Trade Task Force*.

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