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The North American Free Trade Agreement and U.S. Agriculture

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The North American Free Trade Agreement (NAFTA), which was implemented on January 1, 1994 between the United States, Mexico, and Canada, created one of the world's largest free trade area. These three countries have a combined population of 381 million people, $7.8 trillion in annual economic output, and annual trade exceeding $1.4 trillion.

The purpose of NAFTA is to expand the flow of goods, services, and investment among the three participating nations. Specific objectives include:

1. the full, phased elimination of import tariffs;
2. the elimination or fullest possible reduction of nontariff trade barriers, such as import quotas, licensing schemes, and technical barriers to trade;
3. the establishment of clear, binding protection for intellectual property such as patents and copyrights; and
4. fair and fast dispute settlement.

The trade pact is designed so that each member country receives significant preferential trade status in the market of the other NAFTA partners. Trade restrictions applied by the three countries to imports from all other countries will remain in effect unless modified by the World Trade Organization (WTO).

In agricultural trade, NAFTA contains two separate bilateral agreements, one between the United States and Mexico and another between Mexico and Canada. No new agricultural trade agreements were negotiated between the United States and Canada under NAFTA because a Canada-U.S. Trade Agreement was ratified in 1989, negotiations were on-going under GATT, and there was little desire on Canada's part to liberalize trade in economically sensitive sectors such as dairy and poultry. Because U.S.-Canada agricultural trade was excluded from NAFTA, this leaflet focuses on U.S.-Mexico trade.

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% to 10%-20%. 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 $4.5 billion in 1994. 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.

The sharp devaluation of the Mexican peso has dampened short-term export opportunities. U.S. exports of most food products declined 25-35% 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% in one year and vegetable exports to the U.S. also increased.

Longer term, Mexican market fundamentals remain sound. With a growing population, more two-income earning families, and diversification of diets, Mexico will remain a major market for U.S. food and fiber. About two-thirds of the Mexican population is below the age of 30 and one-half is below the age of 20. Consumers in this age group are approaching their peak consumption years. An estimated 40% of all Mexican households have two adults working outside the home, adding to purchasing power. Mexico has about 92 million people and a growth rate of 2.1%, which means a population of 126 million by 2010. However, an estimated 84% of Mexicans currently have per capita incomes below $865 per

year. Market potential will be limited without substantial improvement in per capita incomes.

U.S. agricultural imports from Mexico were valued at $2.9 billion in 1994. Major imports were vegetables, live animals--mainly feeder cattle, coffee, fruits, nuts and malt beverages.

Assessing the likely impact of NAFTA is complex because trade, employment, and economic growth are linked. Benefits to Mexico are expected through the lower prices achieved by tariff reductions; greater efficiency, for example, from streamlined border procedures; and more jobs created by economic development. 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 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. Overall, the net benefits depend on the balance between trade gains and losses and the resulting impacts on prices, jobs, income, taxes, and social costs.

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 $2.0 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.

Impacts on Selected Commodities

Beef and Cattle. Mexican duties of 20% on fresh and chilled beef, and 15% on live cattle, were eliminated on January 1, 1994. U.S. exports of beef were up 84% in 1994, to 72,000 tons. The Mexican market represents about 5% of all U.S. beef exports. Exports declined to 29,000 tons in 1995 because of the devaluation of the Mexican peso. 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. The demand for imported beef could reach 200,000 metric tons by the year 2004.

Higher prices for beef and beef by-products will have a positive impact on cattle prices, on balance. However, 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 animals. Meat exports boost beef and cattle prices but imports of feeder steers reduce them.

Feedlots, meat packers, and processors should benefit from larger export volumes. It has been estimated that at least 432,000 additional fed steers will be required to meet Mexican import demand. U.S. feedlot operators would experience small gains associated with additional volume. Feed grain producers will also benefit because these steers should consume an additional 351,000 tons of feed grains.

For U.S. stocker operators, Mexican cattle are a low cost source of cattle to graze wheat pasture. 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 for 1995. Major constraints to increased live cattle imports are limitations on herd size due to drought, breed characteristics, increased demand for meat in Mexico, and compliance with U.S. animal health regulations related to bovine tuberculosis.

Poultry. U.S. poultry exports to Mexico have tripled, from 51,000 tons in 1990, to 157,000 tons in 1995. Mexican imports 8% of total U.S. poultry exports. About 55% of these exports are broilers and 34% are turkeys. In 1994, Mexico turkey imports were 60% percent of total U.S. exports. U.S. exports are expected to continue to increase by an additional 78.2 million broilers and turkeys, 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.

Grains. A 15% seasonal tariff on grain sorghum was eliminated on 1/1/94. Corn will be liberalized more slowly because of its political and social importance in Mexico. Under a new tariff-rate quota, 2.5 million tons of corn may now enter Mexico duty free each year. The duty-free quota will grow three percent annually, and the 215% duty on over-quota corn imports will be eliminated over 15 years. During 1995, about 2.1 million tons of grain sorghum and 3.0 million tons of corn were exported to Mexico. Because of high prices, the quota was raised to 7.0 million tons for 1996. U.S. feed grain demand will increase, as exports grow and as more feed grains are fed to cattle, hogs, and poultry. However, supply and demand conditions in the rest of the world are the dominant factors affecting prices.

Wheat. U.S. wheat exports have expanded from 321,000 tons in 1990 to 791,473 in 1995. NAFTA will result in gains for input suppliers and grain elevators as trade volume expands. It should be noted, however, that NAFTA does not discipline transportation subsidies used by the Canadian Wheat Board and that the Board may have a distinct market advantage in Mexico. In fact, intense competition from Canada has curtailed U.S. export growth in recent years. Price impacts will be small because wheat prices are determined by global factors.

Rice. Exports to Mexico should expand moderately as Mexico lowers its current 10% duty on rough rice and a 20% duty on milled rice. Both duties will be phased out over 10 years. U.S. rice exports have increased 24% since 1990, to 307,869 tons in 1995. This represents

about 10% of total U.S. exports. Export growth should result in slightly higher prices for producers and consumers.

Cotton. U.S. cotton producers should benefit from increased exports and slightly higher prices as Mexico's 10% duty is reduced over 10 years. Since 1990, U.S. cotton exports to Mexico have expanded from 204,500 bales to 485,706 bales. Mexico will gain greater access to the U.S. market as the Section 22 quota is replaced by a tariff-rate quota, but additional exports to the U.S. are not expected.

Peanuts. NAFTA should have a small positive impact on U.S. peanut producers. U.S. exports can be expected to increase moderately from 15,000 tons in 1994 to about 19,000 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 (17-35% ad valorem), will increase. U.S. fresh and frozen vegetable imports increased 32%, from 1.4 million metric tons in 1994 to 1.8 million tons in 1995. Tomato imports were up 50% to 593,000 tons, cabbage was up 56% to 10,410 tons, carrot imports doubled to 30,601 tons, cauliflower was up 28 percent to 193,709 tons, lettuce imports increased four-fold to 18,499 tons, squash was up 10% to 113,217 tons, while pepper imports were up 28% to 203,969 tons. Imports of cucumbers, okra, and onions declined during this same period.

As U.S. trade barriers are phased out, expanding imports will cause lower prices and returns to U.S. producers. In response to sharply lower prices, the Florida tomato industry filed complaints with the U.S. International Trade Commission (ITC) and requested a seasonal import quota on Mexican tomatoes, coupled with an import duty.

U.S. exports of noncitrus fruit, such as peaches, apples, and pears will increase as Mexico lowers its duties. U.S. exports of fresh deciduous fruits have increased from 57,000 tons in 1990 to 129,182 tons in 1995. Apples and pears accounted for 82% of the 1995 trade volume. Greater sales to the Mexican market should occur as more consumers develop a taste for, and are able to afford, fresh fruits. Sanitary and phytosanitary restrictions, however, may limit trade to some degree.

Some U.S. seasonal duties on oranges and grapefruit were eliminated on 1/1/94, while other duties will be phased out over ten years. 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 impacts 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.

Fresh fruits and vegetables imported from Mexico must comply with U.S. marketing order provisions unless such produce is destined for processing in which case it is exempt. However, U.S. producers are concerned that as more Mexican produce is allowed into the market, the potential will increase for low quality products to enter U.S. fresh marketing channels, driving down prices.

Additional imports may lead to increased concerns about food safety and the presence of chemical residues on fresh products, even though imports must meet U.S. sanitary and phytosanitary regulations. Higher import volumes are likely to lead to increased concerns about imported animal and plant diseases and pests. Larger import volumes mean that the taxpayer costs of monitoring and inspection will increase.

Agribusinesses associated with these industries can expect both positive and negative impacts. Suppliers of seed, fertilizer, and other chemicals may experience minor losses as the production of some crops declines. Specialized infrastructure, such as packing shed operations, may gain as imported volume expands and capacity increases. Some operations may survive only by relocating nearer to production areas in Mexico. Both farm and nonfarm labor can expect some lost employment opportunities as imports of Mexican produce expand. The overall impact on employment cannot be predicted with presently available information.

Dairy Products. Under NAFTA, there is the potential for more commercial exports of milk powder and evaporated milk to Mexico. During 1995 nonfat dried milk exports to Mexico were 28,000 tons, down from 34,000 tons in 1994. Evaporated and condensed milk exports increased from 1,500 tons to 13,644 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 twenty percent tariff to be eliminated over ten 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 over 4,600 tons in 1995.

Lower Mexican tariffs on fluid milk, which will decline from 10% to zero over ten 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 transition 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 20-25 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. Current over-quota duties of $.16 per pound on Mexican imports will be reduced and eventually eliminated.

Both U.S. and Mexican duties on high fructose corn syrup (6-15%) 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.

Wood Products. Expanded exports of wood products can be expected as tariffs are reduced. Most of the positive impacts from NAFTA will be associated with additional demand growth, because Mexico expects to add over one million new housing units annually through the year 2000. U.S. exports of hardwood logs and lumber, framing lumber, and hardwood chips can be expected to increase. Most duties will be eliminated either immediately or over a 5-year transition period. Additional demand for U.S. wood products is expected, because there is a strong and growing furniture and lumber manufacturing industry in Mexico, which exports a large share of its volume back to the U.S. market.

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 cause consumers to demand more convenient packaging of food products and foods with less preparation time. This should lead to increased demand for pre-prepared food and consumer-ready items. 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. Many U.S. firms, however, are undertaking direct investment in Mexico. Recent changes in investment laws have made it easier for U.S. business to own land, facilities, and other Mexican assets. As the Mexican economy improves and wage rates rise, the incentive to locate in Mexico solely to take advantage of lower wage rates will decline.

Concluding Remarks

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. These 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 which will benefit. Some labor intensive fruit and vegetable producers are likely to be adversely affected by NAFTA, at least in the short run. However, even the fruit and vegetable industry may see some benefits over the longer term, as stronger economic growth in Mexico stimulates increased 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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