

The North American Free Trade Agreement: What Is at Stake for U.S. Agriculture?

By Alan Barkema

U.S. agriculture has a keen interest in the proposed agreement to create a North American free trade area. As proposed, the North American Free Trade Agreement, or NAFTA, would pull down trade barriers between the United States and Mexico and further open the door to a rapidly growing market for U.S. farm exports.

Efforts to create a free-trade area in North America began with the Canadian-U.S. trade agreement, or CUSTA, which went into effect in 1989. The NAFTA would extend the new free trade area to Mexico. While Canada is a party to the new NAFTA accord, the major players are Mexico and the United States because the CUSTA has already addressed many major farm trade issues between the United States and Canada.

The NAFTA negotiations got under way in June 1991 and concluded with the announcement in August by President Bush that negotiators from the three nations had reached agreement. The draft text of the proposed accord was released early in September. Before the new trade accord can go

into effect, Congress must give approval.

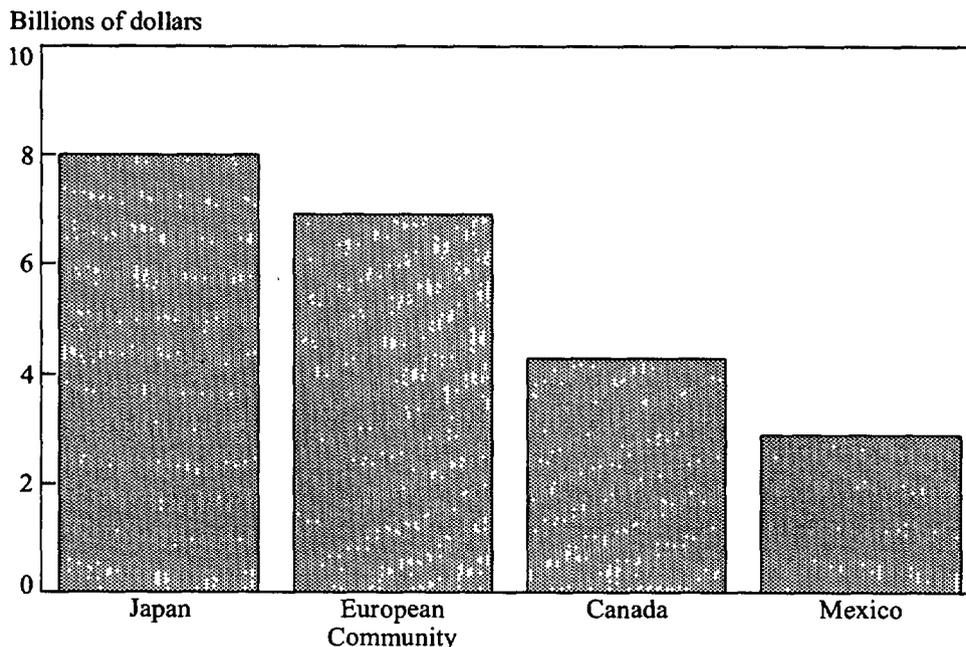
The steps to Congressional approval of the NAFTA treaty are spelled out under the timetable of the "fast-track authority." According to the fast-track timetable, the President must notify Congress of his intent to enter into the new trade accord at least 90 calendar days before he signs the agreement. Once the agreement is signed, Congress has 90 session days (about eight months) to approve the new agreement and any implementing legislation on a thumbs-up or thumbs-down vote without amendment. If approved, the NAFTA would most likely go into effect in January 1994.

The impact of an approved NAFTA on North American farm trade may still depend heavily on the outcome of the global trade talks. The Uruguay Round of the General Agreement on Tariffs and Trade (GATT) are still in progress. But a long dispute between the European Community and the United States over farm trade issues has stalled—and may sink—the Uruguay Round, despite six years of negotiation. Still, many of the most important farm trade issues are global rather than regional in scope, a fact that both the CUSTA and the proposed NAFTA have acknowledged.

With the NAFTA on the horizon for U.S. agriculture, three important questions stand out:

Alan Barkema is a senior economist at the Federal Reserve Bank of Kansas City. Tim Sheesley, an assistant economist at the bank, and Creg Shaffer, a research associate, helped prepare the article.

Chart 1
U.S. Agricultural Exports, 1990-92 Average



Source: U.S. Department of Agriculture, Economic Research Service.

What are the major farm trade issues in the NAFTA? What benefits can U.S. agriculture expect from freer North American trade? And, how successful is the NAFTA likely to be in reforming farm trade on the continent?

This article explores these three questions. The first section provides an overview of farm trade in North America and describes the major farm trade flows and trade barriers. The second section assesses the potential gains in U.S. net farm exports with freer North American trade. The third section considers the NAFTA's prospects for pulling down farm trade restrictions in North America. The article concludes that the NAFTA could provide modest benefits to U.S. agriculture, but the industry's gains in the NAFTA still depend heavily on the outcome of the Uruguay Round.

AN OVERVIEW OF NORTH AMERICAN FARM TRADE

Tearing down trade barriers in North America is of keen interest to U.S. agriculture because Canada and Mexico are key markets for U.S. farm products. While farm trade between Canada and Mexico is relatively small, large volumes of farm products flow between the United States and each of its two closest neighbors.

Canada and Mexico are U.S. agriculture's third and fourth largest markets after Japan and the European Community (EC) (Chart 1). In recent years, these two neighbors of the United States have purchased nearly a fifth of all U.S. farm exports. Dominating U.S. farm exports to Mexico are grains and oilseeds and livestock products. The

Table 1

U.S. Farm Trade with Canada and Mexico in 1990

U. S. exports	To Canada		To Mexico	
	\$1,000	%	\$1,000	%
Livestock and products	802,216	19	662,068	26
Grains, oilseeds, and products	848,609	20	1,287,490	50
Fruits, juice, and vegetables	1,709,397	41	237,020	9
Other	837,193	20	367,038	14
Total	4,197,415	100	2,553,616	100

U.S. imports	From Canada		From Mexico	
	\$1,000	%	\$1,000	%
Livestock and products	1,491,822	47	466,199	18
Grains, oilseeds, and products	775,334	25	71,298	3
Fruits, juice, and vegetables	280,211	9	1,346,360	52
Other	605,018	19	726,851	28
Total	3,152,385	100	2,610,708	100

Source: U.S. Department of Agriculture, Economic Research Service.

major farm exports to Canada are horticultural products (fresh and processed fruits and vegetables), grains and oilseeds, and livestock products (Table 1).

The United States is also a critically important market for Mexican and Canadian farmers, absorbing more than three-fourths of Mexico's farm exports and about a third of Canada's. Mexico's major food sales to the United States are warm weather crops—primarily fresh fruits and vegetables, fruit juice, and other tropical crops like coffee and sugar—crops that generally complement the seasonal production in the U.S. Sun Belt states. In addition, annual imports of feeder cattle from Mexico have risen to about a million head in recent years, supplementing the relatively tight supply in the United States. Canada's major farm exports to the United States are feeder cattle, various meat products (especially pork), and grain and oilseed products.

Barriers to farm trade in North America

The NAFTA seeks to remove the numerous barriers that restrict agricultural trade in North America. The primary players in the proposed accord are the United States and Mexico. Many farm trade issues between Canada and the United States were previously addressed in the CUSTA. And farm trade issues between Canada and Mexico are less important due to the almost negligible volume of farm trade between the two countries.¹ Mexico uses an array of tariff and nontariff barriers to protect its many small farmers from the rigors of foreign competition. The United States restricts imports to protect the domestic horticultural industry and to ensure the safety of food imports from Mexico (Table 2).

Mexican trade barriers. Opening the border to farm imports from the United States and else-

Table 2

Major Restrictions on Farm Trade Between Mexico and the United States

	Import restrictions imposed by:	
	Mexico	United States
Livestock products	<ul style="list-style-type: none"> ◦ 20% tariff on most pork products ◦ 10% tariff and license requirement on poultry products ◦ 10-20% tariff and license requirement on most dairy products ◦ Sanitary requirements 	<ul style="list-style-type: none"> ◦ Dairy and meat quotas ◦ Tariffs on many dairy, meat, and poultry products ◦ 1.2% tariff on live cattle ◦ Sanitary requirements
Grains and oilseeds	<ul style="list-style-type: none"> ◦ 0-20% tariff on most grains ◦ Seasonal 10% tariff on soybeans ◦ Seasonal 15% tariff on sorghum ◦ License requirements 	<ul style="list-style-type: none"> ◦ Some small tariffs
Horticultural products	<ul style="list-style-type: none"> ◦ 10-20% tariff ◦ License requirements 	<ul style="list-style-type: none"> ◦ Seasonal tariffs of up to 25% on many fresh vegetables ◦ 35% tariff on dried onions, garlic, cantaloupe, melons ◦ Phytosanitary regulations

Source: U. S. Department of Agriculture, Foreign Agriculture Service 1991a, 1991b, 1992.

where is an especially sensitive issue for Mexico. The Mexican government has a long tradition of safeguarding the interests of the nation's large number of small farmers.² About a third of the Mexican population live in rural areas and about a fourth are employed in production agriculture. The primary objective of Mexican farm policy is to boost incomes for small farmers, thereby minimizing rural unrest and slowing the pace of migration to Mexico City and other crowded urban areas. An important component of Mexican farm policy is restricting imports of low-cost farm products from the United States and elsewhere. By blocking farm imports at the border, Mexican farm policy pushes up farm prices and incomes (see appendix).

Mexico restricts imports of U.S. farm products with tariffs and import license requirements. Tariffs range up to 15 percent for grain and oilseed products and up to 20 percent for various meat, dairy, and horticultural products. Overall, the average tariff on U.S. farm exports to Mexico is about 5 percent.

License requirements are a thinly veiled method of enforcing import quotas. They are the primary restriction on many of the most important U.S. farm exports to Mexico. In many years, import licenses for corn and wheat are not granted until the entire domestic crop is used. Import licenses for horticultural crops effectively close the Mexican border to U.S. imports during the Mexican harvest season. And a combination of

license requirements with tariffs limits imports of U.S. poultry and dairy products.

U.S. trade barriers. The United States also maintains barriers to food imports from Mexico. Tariffs protect domestic producers from foreign competition, and stringent technical regulations on food imports guard the quality and safety of the U.S. food supply.³ The average tariff facing Mexican farm exports to the United States is about 6 percent, slightly greater than the average tariff facing U.S. farm exports to Mexico (USDA).⁴ But Mexican farm exports to the United States are subject to relatively few quantitative restrictions—quotas or import licensing schemes. The U.S. horticultural industry receives the greatest protection from Mexican imports. The average tariff on U.S. imports of horticultural products from Mexico is about 8 percent, and seasonal tariffs of up to 35 percent are assessed during the U.S. harvest season (USDA, Foreign Agricultural Service 1991a).

Quality, health, and sanitary standards play a prominent role in regulating U.S. imports of horticultural and livestock products from Mexico. For example, the United States strictly regulates the use of farm chemicals on imported horticultural crops.⁵ Mexican authorities also cooperate with the U.S. Department of Agriculture to limit the spread of the Mediterranean and Mexican fruit flies into U.S. citrus producing areas. Imports of fresh citrus products are generally restricted to those grown in a few areas of Mexico that have been certified “fly free.” And the United States maintains strict health and sanitary standards on livestock product imports to ensure a healthful food supply and prevent the spread of contagious livestock diseases prevalent in Mexico.⁶

HOW MIGHT THE NAFTA BENEFIT U.S. AGRICULTURE?

One measure of the benefit U.S. agriculture might receive from the NAFTA is the potential gains in net exports of each of the major com-

modities U.S. farmers sell to Mexico.⁷ But these gains from the NAFTA must be measured against a background of rapidly growing Mexican demand for U.S. farm products. As Mexican food demand grows and trade barriers fall, net exports of most U.S. farm products should rise.

The turnaround in the Mexican economy

The strength of Mexican demand for U.S. farm products is a key factor in the outlook for gains in U.S. farm trade with Mexico in the years ahead. Even without changes in trade rules in the prospective NAFTA, U.S. farm exports to Mexico should grow as Mexico continues to rely on its leading farm trade partner to fill bigger shortfalls in domestic food production. If the NAFTA could eliminate or significantly reduce the barriers that block trade between Mexico and the United States, the door to the rapidly growing Mexican market for U.S. farm products would open even wider.

A sea change in Mexico’s economic policy has reinvigorated the nation’s economy, and further gains in consumer incomes and food demand lie ahead. Beginning in 1985, Mexico began freeing its economy from protectionist trade measures and state controls that had virtually ensured the nation’s chronic inefficiency and stagnation.⁸ With the dramatic policy shift, real GDP growth is expected to reach 5 to 6 percent a year by the mid-1990s (Shane and Stallings).

Stronger income growth will boost food demand in Mexico. On average, Mexican consumers spend more than a third of their incomes on food, a far higher proportion than in higher income countries like the United States (Table 3). As incomes rise in the rejuvenated economy, Mexican consumers will make upgrading their relatively low-quality diets a priority.⁹ Meanwhile, the Mexican population is much younger and growing more than twice as fast as the U.S. population. Growing incomes and a relatively young, rapidly growing population are a potent recipe for boosting food demand.

Prospects for U.S. farm exports

How will U.S. net farm exports to Mexico change if the NAFTA is implemented? Quantitative analyses of how the specific provisions of the proposed agreement will affect farm trade are not yet available. But several earlier studies frame the likely effects of a reduction in farm trade barriers between Mexico and the United States.

Livestock products. Increased meat consumption is likely to anchor the improvement in Mexican diets and boost meat imports from the United States. Mexican meat production has generally kept pace with current domestic consumption, leaving a relatively small gap to be filled by imports from the United States. Early on, the Mexican livestock industry probably could not keep pace with a surge in meat demand, creating an opportunity for U.S. meat producers to fill a widening meat supply gap.¹⁰ But in the years ahead, expansion in Mexican meat production is likely with the improving investment climate in Mexico. Growing Mexican meat production would limit the gains in U.S. meat exports.

While a reduction in trade barriers could pave the way for modest gains in U.S. meat exports to Mexico, it could also open the door to increased U.S. imports of Mexican feeder cattle. A key concern of U.S. cattle ranchers is that a stampede of Mexican feeder cattle into the U.S. would drive down domestic feeder cattle prices.¹¹ As Mexican meat production rises, however, the supply of Mexican feeder cattle available for export to the United States will probably shrink, easing competitive pressures for U.S. ranchers. Overall, freer trade with Mexico would probably provide a modest net benefit to the U.S. livestock industry.

Grains and oilseeds. Growth in the Mexican food market could have the biggest impact on U.S. grain and oilseed exports. But reducing Mexico's trade barriers will be a key to achieving the market's full potential. Expanded meat production in Mexico will spark increased demand for grains and oilseeds (mainly corn and soybeans) to feed

Table 3

Indicators of Food Demand in Mexico and the United States

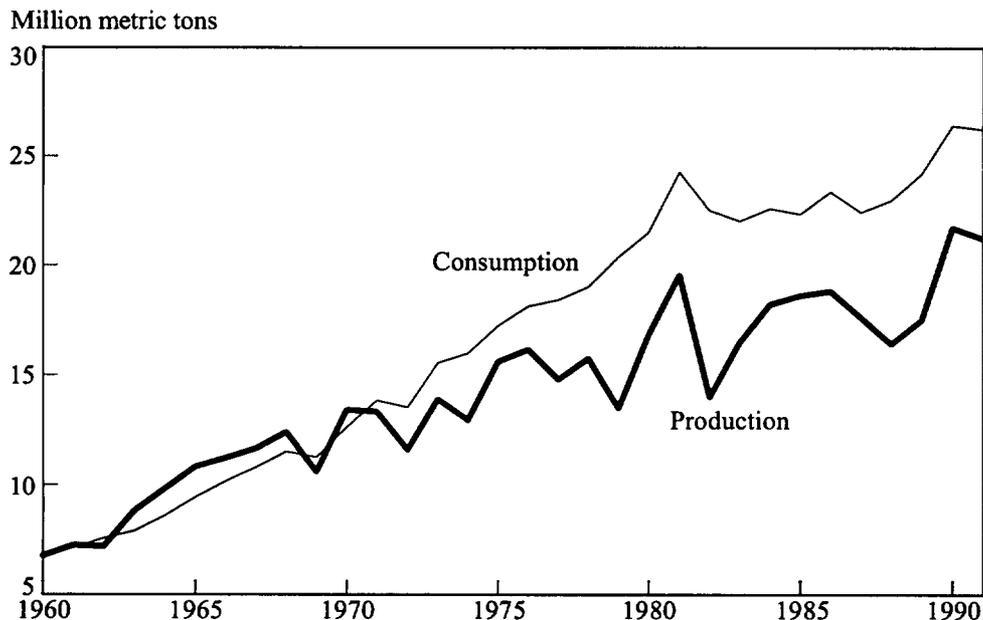
	Mexico	United States
GNP per capita (1990)	\$2,490	\$21,790
Annual GDP growth (%)		
1980-88	.5	3.2
1988-90	2.9	2.4
Food share of household consumption (%)	35.0	13.0
Annual population growth 1988-2000 (%)	1.9	.8
Share of population under 14 years old (%)	38.6	21.6

Source: The World Bank and author's calculations.

the nation's larger herds and flocks. Mexico's ability to boost grain production, however, is constrained by limited rainfall and irrigation. Mexico has long relied on U.S. farmers to fill the large gap between domestic grain production and consumption (Chart 2). In recent years, U.S. grain exports to Mexico have averaged about 6 million metric tons, roughly three-fourths of Mexico's total grain imports. Thus, a spurt in Mexico's food demand would create a prime opportunity to boost U.S. grain exports.

U.S. grain exports to Mexico would probably increase somewhat even without a change in trade rules, although an easing of Mexico's tight restrictions would allow an even bigger increase. Peterson estimates that by 1995 Mexican imports could

Chart 2

Grain Production and Consumption in Mexico

Source: U.S. Department of Agriculture, Economic Research Service.

jump about 25 percent for corn and wheat and 6 percent for soybeans with no changes in trade rules (Table 4). If the entire increase in Mexican imports came from the United States—an only slightly optimistic assumption—total U.S. exports would increase 2 percent for corn and marginally for wheat and soybeans. But if Mexico's restrictions on grain imports were completely eliminated, these gains in U.S. exports could triple.¹² Thus, the NAFTA would at best push up total U.S. grain and oilseed exports several percentage points, a significant but still modest increase.

Horticultural products. Contrary to perceptions, the growing Mexican market could also create new export opportunities for fruit and vegetable producers in the southwestern United States. Mexican consumption of horticultural

products is likely to surge as consumers improve their diets. But Mexican fresh fruit and vegetable growers may be hard pressed both to supply a growing domestic market and to expand exports to the United States. Most Mexican producers are small farmers without access to the latest production technologies. Expansion in the Mexican horticultural industry may require investment by producers from the United States and elsewhere (Cook). Thus, growing food demand in Mexico could ease the pressure U.S. producers might otherwise feel from larger imports from Mexico under freer trade.

Still, Mexico is the leading supplier of horticultural products to the United States, and U.S. imports of some Mexican products could expand as trade restrictions fall away. A favorable climate

Table 4

Prospective Gains in Mexican Grain Imports by 1995

	Current trade rules			Free trade		
	Increase in Mexican imports		Increase in total U.S. exports	Increase in Mexican imports		Increase in total U.S. exports
	(1000 metric tons)	(percent)	(percent)	(1000 metric tons)	(percent)	(percent)
Corn	977	25.5	2.1	2,814	73.4	5.9
Wheat	141	24.7	.4	429	75.0	1.2
Soybeans	99	6.0	.6	348	21.2	2.0

Sources: Peterson and author's calculations.

enabling production of fresh vegetables which are out-of-season in the United States is Mexico's primary competitive advantage.¹³ The presence of Mexican and Mediterranean fruit flies in Mexican production regions will constrain U.S. imports of fresh fruit from Mexico. But imports of Mexican orange juice could increase as tariffs fall, creating greater competition for Florida orange juice producers (Spreen). And increased investment by U.S. firms in the Mexican food processing industry could boost U.S. imports of various canned and frozen fruits and vegetables (USITC).

Thus, the outlook for the U.S. horticultural industry under the NAFTA is mixed. The NAFTA could boost exports to Mexico for some products and boost imports from Mexico for others. On balance, freer trade with Mexico could have a modest negative effect on the U.S. horticultural industry.

Net gains. In sum, freer North American trade would benefit some parts of U.S. agriculture more than others. U.S. feedgrains producers would reap the biggest rewards, as export sales rise to fuel larger meat and poultry production in Mexico. The U.S. livestock industry could also expect a slight gain in net export sales, but the U.S. horticultural

industry may feel increased pressure from Mexican imports.

Overall, freer trade in North America should result in a net gain in U.S. farm exports, but the gains are likely to be modest. For example, even a doubling of U.S. export sales to Mexico—a prospect which seems optimistic at this time—would boost total U.S. farm exports only 7 percent.¹⁴ Meanwhile, a modest increase in farm imports from Mexico is likely. On balance, an overhaul of trade rules with Mexico would probably add a few percentage points to total U.S. net farm exports.

HOW MUCH REFORM CAN THE NAFTA DELIVER?

The draft text of the NAFTA accord proposes a major overhaul of farm trade rules in North America. After a lengthy transition period, the NAFTA promises to eliminate most barriers to farm trade on the continent. Still, some vexing farm-trade problems will remain, since many of the most difficult problems require a *global* rather than a *regional* solution. This section summarizes the major farm-trade provisions of the proposed

NAFTA accord and draws on lessons learned in the CUSTA and the Uruguay Round to highlight the NAFTA's likely successes and shortcomings.

Farm trade provisions in the NAFTA

As proposed, the NAFTA would spell out separate bilateral agreements on farm trade between Mexico and the United States and between Canada and Mexico. The CUSTA would continue to regulate farm trade between Canada and the United States. The greatest contribution of the proposed NAFTA to farm trade is the eventual elimination of tariff and nontariff barriers between the United States and Mexico. But the gains will unwind slowly, thanks to a lengthy transition period and "safeguard" provisions. Moreover, the new agreement makes virtually no headway in scaling back trade-distorting farm subsidies.¹⁵

Tariff and nontariff barriers. The NAFTA will change the rules of farm trade between the United States and Mexico most significantly by tearing down tariff and nontariff trade barriers. Tariffs on some farm products would be eliminated immediately, while others would be phased out during a period of 5, 10 or 15 years. The longest phase-out period would be reserved for producers who are most sensitive to trade liberalization, including corn producers in Mexico and producers of sugar, orange juice, and various other horticultural crops in the United States.

The NAFTA would also eliminate immediately all nontariff barriers—like the licensing requirements Mexico uses to restrict imports of U.S. grain. But for some products the old nontariff barriers would be replaced with a system of quotas and tariffs designed to duplicate their restrictive effect on imports. These new restrictions would gradually be removed during the transition period. For example, the licensing requirement restricting U.S. corn sales to Mexico would be eliminated when the NAFTA goes into effect, but U.S. exporters would be allowed to ship only 2.5 million metric tons (MMT) to Mexico duty free in the

first year of the new agreement. Additional corn exports in excess of the 2.5 MMT quota would be constrained by a new 215 percent tariff.

These restrictions on U.S. corn exports to Mexico would be phased out during a 15-year transition period by increasing the duty-free quota by 3 percent per year and by decreasing the tariff on exports in excess of the quota.¹⁶ Thus, the NAFTA promises to open the door for U.S. corn exports to Mexico, but the door would swing open slowly.

The NAFTA also proposes changes to rules on trade in livestock products between the two nations. The agreement would remove Mexico's import license requirement on imports of U.S. poultry, and tariffs on most meat and poultry products would be phased out in 10 years. Mexican imports of most U.S. beef products would remain tariff-free.

The prospective agreement also includes strong "rules of origin" to prevent non-NAFTA countries from unfairly benefitting from the reduction in trade barriers within the new free-trade area. In brief, these rules would limit the NAFTA's preferential trade rules to products produced in the NAFTA countries. Products produced in a non-NAFTA country and shipped through one NAFTA country into another would not be eligible for the NAFTA's lower tariffs. The rules of origin are especially important for many manufactured products, such as automobiles and textiles, and some agricultural products, notably sugar.

Safeguard provisions. To ease the adjustment of some industries to freer trade, the NAFTA proposes a set of safeguard provisions, in addition to a long transition period. The safeguard provisions allow the importing country to reimpose tariffs during the first ten years of the agreement whenever imports rise to a trigger level. Thus, producers are protected from a surge in imports as they gradually adjust to freer trade.

In the United States, the safeguard provisions apply to imports of tomatoes, onions, eggplants,

Chili peppers, squash, and watermelons, which comprise about 15 percent of total U.S. farm imports from Mexico. In Mexico, the safeguard provisions apply to imports of live swine, pork products, potato products, and apples, which comprise about 3 percent of total U.S. exports to Mexico.

Farm subsidies. In contrast to the NAFTA's promised gains in phasing out tariff and nontariff barriers, the new agreement would wind down farm subsidies little, if at all. The proposed agreement identifies two types of farm subsidies: domestic supports, which encourage excess production, and export subsidies, which push farm products onto world markets at discount prices. But the agreement offers little reduction in trade distortions caused by either.

The NAFTA text acknowledges the production and trade distorting effects of domestic supports and encourages Canada, Mexico, and the United States to adopt policies which have minimal effects on production and trade. But the proposal provides no guidelines or timetable for reducing domestic supports, effectively deferring the issue to the Uruguay Round.¹⁸

Similarly, export subsidies are virtually untouched by the prospective agreement. The proposal recognizes that export subsidies are inappropriate within the free trade area, due to the disruption they can cause in the markets of an importing country. Nevertheless, the proposal allows for the use of export subsidies within the free trade area to counter subsidized exports from non-NAFTA nations.¹⁹ The proposal also spells out several rules on the use of export subsidies in the new free trade area. These include a provision for consultations between the exporting and importing countries and a requirement that a NAFTA exporting country provide three days' notice of its intent to introduce a subsidy on exports to another NAFTA country.²⁰ But otherwise, the prospective NAFTA promises no reduction in export subsidies, deferring this issue—along with domestic supports—to the Uruguay Round.²¹

Lessons from the CUSTA

The CUSTA, which will continue to apply to farm trade between Canada and the United States, provides useful insight into how effective the NAFTA will be in reforming farm trade between Mexico and the United States. In many ways, the CUSTA was prologue to the NAFTA, illustrating the limitations of regional trade negotiations to achieve meaningful farm trade reform during a global trade conflict. The CUSTA tinkered at the edges of farm trade reform, addressing bilateral trade irritants between Canada and the United States while deferring the most substantive issues to the Uruguay Round.²²

The CUSTA's greatest success was eliminating tariffs on food and agricultural products. Under the CUSTA, all tariffs on farm trade between Canada and the United States will be phased out by 1998, a process already well under way. But even the gradual elimination of tariffs, one of the most visible farm trade barriers, was carefully limited by "snap-back provisions" similar to the safeguards proposed in the NAFTA. The snap-back provisions of the CUSTA allow either the United States or Canada to reinstate tariffs on horticultural products whenever it appears that imports have pushed domestic product prices or planted acreage below certain levels. The snap-back provisions were written into the CUSTA at the insistence of the Canadian horticultural industry, which feared increased competition from a more efficient U.S. industry.

The CUSTA also set a precedent for deferring farm subsidies to the Uruguay Round. In the CUSTA, Canada agreed to drop the license requirement on imports of U.S. grain if grain subsidies become smaller in the United States than in Canada. But the agreement did not require subsidies to be lowered. The CUSTA's only contribution to subsidy reduction was an agreement by the two nations not to subsidize exports to each other. As a part of this agreement, Canada removed the transportation subsidy on shipments of durum

wheat from its west coast ports to the United States.

But even this simple regional agreement on export subsidies is almost unworkable in a global trading environment replete with subsidized exports. For example, Canada complains that subsidized sales of U.S. wheat to northern Africa and other parts of the world, which are also important markets for Canadian wheat, have the same effect on Canadian wheat growers as subsidized sales to Canada. Still, the United States is reluctant to stop its wheat export subsidies for fear of losing important markets to subsidized shipments from the EC. Thus, the vexing problems resulting from incomplete treatment of export subsidies in the CUSTA sound a note of warning for the NAFTA as well.

Despite the CUSTA's shortcomings, however, farm trade between Canada and the United States widened during the first two years of the agreement. Farm exports from each country to the other increased about 30 percent, while exports to other countries stayed nearly flat (Goodloe and Simone). Thus, even though the NAFTA shares several shortcomings with the CUSTA, it may bolster farm trade between Mexico and the United States. Still, the longer transition period in the NAFTA suggests that gains in U.S. farm trade may evolve more slowly with Mexico after the NAFTA than with Canada after the CUSTA.

Lessons from the Uruguay Round

Neither the prospective NAFTA nor the CUSTA has diminished the importance of the Uruguay Round to world food trade.²³ Competition in the world food market has flared into a global farm trade war. The major producers bar farm imports from entering their domestic markets, while they dump their subsidized surpluses abroad. An agreement in the Uruguay Round would end this global dispute by pulling down tariffs and nontariff barriers to farm trade, reducing farm production and export subsidies, and harmonizing technical regulations. The United States has led

the call for a reduction in these trade distorting farm policies, but no nation is willing to change its own farm and trade policies unless other nations—principally the EC—follow suit.²⁴

Failure of the Uruguay Round would limit the flexibility for Canada, Mexico, and the United States to make further changes in farm policies they deem vital to competing in the world market. Against such a backdrop, little real progress is likely in reducing farm subsidies regionally beyond the rhetorical support achieved in the CUSTA and proposed in the NAFTA. For example, Canada and the United States would remain reluctant to wind down farm subsidies that encourage the production and export of surplus grain while still locked in a trade dispute with the European Community and others. Meanwhile, Mexico would be reluctant to reduce the support it furnishes to its myriad small corn farmers.

On the other hand, a successful Uruguay Round would simultaneously accomplish many of the NAFTA's goals. Canada, Mexico, and the United States are all Uruguay Round participants, and a global agreement requiring open borders and lower subsidies would resolve many of the problems remaining in the NAFTA. In that event, the only remaining objective of the NAFTA would be to make additional marginal gains by relieving trade irritants that are unique to North America.

PROSPECTS FOR THE NAFTA

Mexico's limited means of improving diets for a population growing in size and affluence will create a natural market for many U.S. farm exports. Most segments of U.S. agriculture—especially feedgrains producers—look forward to increasing their sales to Mexican consumers. But numerous trade barriers block U.S. farmers from the growing Mexican market.

The reduction in barriers to farm trade between Mexico and the United States promised in the NAFTA is laudable. The proposed NAFTA's greatest achievement in reforming farm trade

would be to completely eliminate nontariff and tariff barriers. But these trade barriers will fall gradually—especially for corn and other grains, which promise the largest trade gains for U.S. producers. While the provisions of the new agreement are phased in, gains in U.S. farm sales to Mexico are more likely to be caused by further income growth in Mexico rather than by changes in trade rules under the NAFTA.

The slow pace of the Uruguay Round, which would liberalize farm trade worldwide, has focused attention on the NAFTA as an important step toward freer farm trade. But despite the lowering of barriers to farm trade in the NAFTA, the regional accord is likely to be a poor substitute for a global GATT agreement.

If the Uruguay Round fails, the global dispute over farm trade will continue. In North America and the rest of the world, certain critical farm and trade policies that boost domestic farm incomes and guard against subsidized foreign competition would remain in place. In contrast, a successful

Uruguay Round would wind down barriers to farm trade and bring an end to the global contest of farm subsidies. The Uruguay Round would achieve globally much of what the NAFTA seeks regionally. Thus, a successful Uruguay Round would erect a much higher platform for launching the NAFTA. The NAFTA could then focus on smoothing the relatively minor farm trade irritants that may still remain in North America.

The NAFTA appears to hold modest benefits for U.S. agriculture, particularly if the Uruguay Round succeeds. But an evaluation of the NAFTA also hinges on the benefits freer trade offers to Mexico and parts of the U.S. economy outside of agriculture.²⁵ Mexican consumers are almost certain to be big winners in a NAFTA, as they gain greater access to lower cost food imports from the United States. Meanwhile, expansion in nonfarm trade could boost economic activity and employment in both nations. In the end, these broader issues may determine if the proposed NAFTA is implemented.

APPENDIX

Farm Policy in Mexico

Mexican farm policies boost incomes of small farmers by supporting prices of farm products and by subsidizing purchases of farm inputs, such as petroleum products, credit, irrigation, and crop insurance. CONASUPO (Compania Nacional de Subsistencias Populares SA), the Mexican analog of the U.S. Commodity Credit Corporation, is the government entity responsible for implementing Mexican farm programs. CONASUPO buys commodities from farmers at high prices and sells to consumers at lower prices, supporting farm incomes while reducing consumer food costs. The high producer prices are in turn supported by trade barriers that limit the inflow of cheaper farm products from the United States and elsewhere.

The effects of these farm and trade policies are a

Table A-1

Producer and Consumer Subsidy Equivalents in Mexico

(Amounts in percent)

<u>Product</u>	<u>Producer subsidy equivalent</u>	<u>Consumer subsidy equivalent</u>
Corn	75	-59
Sorghum	59	-40
Wheat	20	-1
Soybeans	52	-42
Drybeans	-16	89

mixed blessing. Farmers gain because the policies boost farm incomes. Consumers lose because the policies push up food prices and taxes, despite the government's planned objective of reducing food costs.

The effects of government policies on farm incomes and consumer costs are measured with the producer subsidy equivalent (PSE) and the consumer subsidy equivalent (CSE). The PSE is the gain in farm incomes resulting from government policies and is expressed as a percentage of farm product sales. Similarly, the CSE is the

increase in consumer food costs and taxes expressed as a percentage of food costs.²¹ The policy-induced transfer of income from consumers to producers in Mexico is the biggest for corn, a staple in the Mexican diet (Table A-1). The U.S. Department of Agriculture estimates that government policies account for nearly three-fourths of farm income from corn production in Mexico. Meanwhile, consumer expenditures for corn products would be 60 percent lower in the absence of Mexican farm and trade policies.

ENDNOTES

¹ Mielke describes Canada's role in the NAFTA as largely defensive. Canada seeks to ensure that a special trade deal between the United States and Mexico does not cause Canadian exports to be displaced by Mexican farm products in the U.S. market or by U.S. products in the Mexican market.

² Protection of small farmers has been the cornerstone of Mexican farm policy since the Mexican Revolution of 1910. A major goal of the revolution was to make land available for small farmers, a principle that was institutionalized in the land reform provisions of the Constitution of 1917 (Grindle; Yates). Only recently was the constitution, which created a communal system of small, subsistence farms, amended to allow corporate investment in farming and private rental and sales of farmland.

³ Both nations set quality, health, and sanitary standards for imports of most farm products, especially livestock and horticultural products. Ideally these technical regulations are based on firm scientific evidence of a legitimate health or safety risk. Otherwise, artificial health or safety concerns could be used to conceal an unfair trade barrier. For example, U.S. exporters complain that restrictions Mexico imposed on hog imports from the United States following a hog cholera outbreak in Mexico in 1989 were unfair, because the United States is free of the disease (U.S. General Accounting Office).

⁴ Mexico's status as a developing country makes it eligible for lower tariffs than many other countries under the U.S. Generalized System of Preferences.

⁵ Heightened concerns about the safety of the U.S. food supply have focused attention on the use of farm chemicals on horticultural crops imported from Mexico. One recent study, however, found that chemical residues on farm products imported from Mexico were similar to those on products produced domestically. And the study found no evidence that different standards regulating the use of farm chemicals in Mexico gave Mexican producers an unfair advantage over U.S. producers (Newman).

⁶ Only a few red meat plants in Mexico have been approved by the USDA to export meat products to the United States, and imports of Mexican poultry products are blocked by the absence of an U.S. approved poultry inspection system in Mexico (Rosson and others).

⁷ The evaluation criterion used here, gains in net export sales, views the prospective NAFTA from the perspective of the U.S. farmer. An alternative criterion, such as changes in the availability and cost of food, would view the impact of the prospective agreement from the consumer's perspective. The NAFTA would have little effect on consumer food costs in the United States, because the agreement would result in only slight changes in total U.S. farm trade flows. In contrast, free trade could sharply reduce the cost of food in Mexico by giving Mexican consumers access to cheaper food produced in the United States (see appendix).

⁸ Since joining the GATT in 1986, Mexico has dropped its highest tariff to 20 percent, well below the GATT maximum of 50 percent. Meanwhile, the number of state enterprises, which are generally very inefficient businesses, has fallen from 1,155 to about 120, and many of those remaining are scheduled for sale or liquidation. Aspe (p. 148) applauds these changes in Mexican policy and succinctly summarizes the link between protectionist trade policies and a weak economy stating, "It is painfully obvious that those few countries that still subscribe to protectionist policies are only walking further down that primrose path to self-sufficiency—and poverty."

⁹ Per capita consumption in Mexico is almost double the U.S. level for cereal products and less than half the U.S. level for meat, milk, and horticultural products.

¹⁰ A recent study by Lee and others suggests rising incomes in Mexico and other middle-income countries tend to favor U.S. exports of value-added beef products—like fresh, frozen, or prepared beef—rather than live animals or products that have received less processing.

¹¹ For example, Rosson and others estimate that imports of Mexican feeder cattle pushed down U.S. feeder cattle prices about 7 percent in 1990.

¹² Another recent study also suggests growing incomes in Mexico could trigger significant potential gains in U.S. sales of corn, wheat, and soybeans. The sensitivity of U.S. exports to income growth in the importing country is larger in Mexico than in most other major U.S. export markets for all three crops. Estimated export elasticities suggest a 1 percent increase in Mexican income would boost U.S. exports 1.84 percent for soybeans, 1.95 percent for wheat, and 2.72 percent for corn (Davison and Arnade).

¹³ The advantage of lower labor wage rates in Mexico is partially offset by lower productivity (Cook).

¹⁴ The U.S. Department of Agriculture projects U.S. farm exports to Mexico at \$3 billion in 1992. Total U.S. farm exports are projected at \$40 billion.

¹⁵ Information in this section describing the proposed NAFTA is drawn from the draft text of the agreement, released September 8 (Office of the U.S. Trade Representative, 1992b) and from the proposed tariff schedule (U.S. Department of Agriculture, Foreign Agriculture Service, 1992). For less detailed, preliminary summaries of the NAFTA text, see U.S. Department of Agriculture, 1992; Office of the Press Secretary; the Governments of Canada, the United Mexican States, and the United States of America; and Office of the U.S. Trade Representative, 1992a.

¹⁶ The over-quota tariff would be reduced 24 percent during the first 6 years of the agreement and then reduced in a series of equal annual steps.

¹⁷ The 20-percent tariff on imports of U.S. pork products would be replaced with a tariff rate quota, which would also be phased out over 10 years.

¹⁸ The draft text states that the NAFTA countries "recognize that domestic support measures can be of crucial importance to their agricultural sectors but may also have trade distorting effects and effects on production. The Parties further recognize that domestic support commitments may result from the agriculture negotiations in the Uruguay Round of multilateral trade negotiations under the GATT." The NAFTA countries are encouraged to "move toward domestic support policies that: (a) have minimal or no trade distortion effects or effects on production; or (b) are exempt from domestic support reduction commitments under the GATT." (Office of the U.S. Trade Representative 1992b, Article 705, page 7-2).

¹⁹ According to Article 706 of the draft text, "...the Parties affirm that it is inappropriate for a Party to provide export subsidies for the export of an agricultural good to the territory of another Party *when there are no other subsidized imports of that good into that other Party* [author's emphasis]." (Office of the U.S. Trade Representative 1992b, p. 7-3)

²⁰ The agreement enables the exporting NAFTA country to

request consultation with another NAFTA country that is buying subsidized imports from a non-NAFTA country. If the importing country adopts a mutually agreed measure to counter the external subsidy, the exporting NAFTA country will not introduce its own export subsidy. The agreement would also establish a Working Group on Agricultural Subsidies "to work toward elimination of all export subsidies in connection with trade in agricultural goods between the Parties." (Office of the U.S. Trade Representative, 1992b).

²¹ The proposed NAFTA endorses the global elimination of export subsidies stating, "The Parties recognize that export subsidies may have serious prejudicial effects on importing and exporting Parties, and the Parties share the objective of achieving the multilateral elimination of export subsidies for agricultural goods. The Parties shall cooperate in an effort to achieve an agreement in the *General Agreement on Tariffs and Trade* which eliminates export subsidies on agricultural goods." (Office of the U.S. Trade Representative 1992b, Article 706, p. 7-3).

²² This discussion highlights several major provisions of the CUSTA. See Goodloe and Goodloe and Simone for a more comprehensive discussion of the CUSTA and its relationship to the NAFTA.

²³ Other issues also tie together the GATT and NAFTA. The GATT frowns on regional trade deals on theoretical grounds. The underlying principle of the GATT is that all nations should be treated equally in trade. Thus, each is to extend its best trading terms—most-favored nation (MFN) status—to all other nations. Regional trade deals are a direct violation of the MFN principle.

The problem with a regional trade accord is that the preferred trading terms within the free-trade region can unfairly divert trade from other nations. Still, the GATT will allow free-trade areas to form if they encompass substantially all trade among the member countries and if they do not increase trade barriers to nonmember countries. These conditions help minimize the diversion of trade to member countries from nonmember countries, which may possess a comparative advantage. Generally, the potential for trade diversion, which is harmful to world economic welfare, is small when the members of a new free-trade area are already major trading partners—such as the three participants in the NAFTA. The exchange between Krugman and Bergsten provides a more extensive discussion of the relative merits of global and regional trade reform.

²⁴ Wonnacott and Lutz (p. 60) attribute the slow pace of progress in the international trade talks to two problems, the "free-rider" problem and the "convoy" problem. Free riders hope to leave their trade barriers high while benefiting from the reduction in trade barriers elsewhere. Meanwhile, "the speed of the convoy moving toward freer trade is limited by the speed of the slowest ship."

²⁵ The effects of freer trade on other sectors of the Mexican economy might ease the adjustment facing Mexican agriculture. One study found that the NAFTA would stimulate employment growth in Mexico and have little effect on the overall level of employment in the United States. But real incomes would be likely to fall for unskilled workers and rise

for skilled workers in the United States (USITC). Another study found a net gain of 130,000 jobs in the United States and 609,000 jobs in Mexico (Hufbauer and Schott).

²⁶ Webb and others provide more detailed definitions and the formulas for calculating both PSEs and CSEs.

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