UNIVERSITY OF CALIFORNIA GIANNINI FOUNDATION

UPDATE

Agricultural and Resource Economics

Vol. 9 No. 2 Nov/Dec 2005

Trade and North American Agriculture: Assessing NAFTA at 12

by

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Is NAFTA on the verge of maturity or entering troubled teen years? NAFTA expanded trade in farm commodities as well trade disputes, and was one factor in rising Mexico-U.S. migration. A January 13, 2006 conference will explore these issues.

The North American Free Trade Agreement (NAFTA) turns 12 on January 1, 2006. Is the transition to almost teen status a marker of maturity? Is there consensus that NAFTA illustrates the benefits of free trade, or is this the start of a troublesome period in which the gains from freer trade are increasingly questioned?

Political trends in the United States suggest that support for free trade in agriculture may be weakening. Even those groups that have traditionally supported liberalization, like the California agricultural community, are increasingly wary of new trade agreements. NAFTA was approved in the 435-seat House by 34 votes in 1993, while the similar Central American Free Trade Agreement (CAFTA) was approved by a margin of only two votes in the House in 2005. The President had to cut costly side deals in order to obtain sufficient votes for these trade agreements.

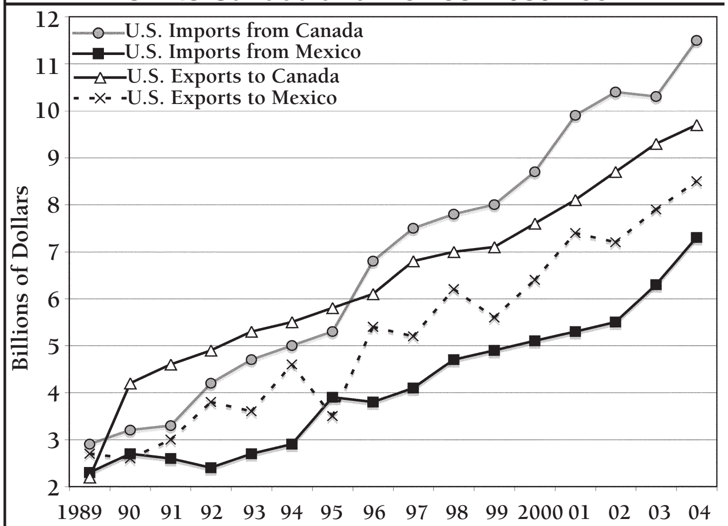
In California, enthusiasm over increased exports to new markets as trade liberalizes is increasingly tempered by concerns regarding increased competition in both the home and third markets. This unease is focused on countries that can compete seasonally with domestic growers, and on emerging agricultural exporters like China that have the potential to displace California products in markets such as Japan.

We examine the promises and pitfalls of freer trade for California agriculture by drawing lessons from the NAFTA experience. NAFTA expanded trade in farm commodities among Canada, Mexico and the United States. There is no doubt that NAFTA changed the agricultural economy of North America profoundly, but it did not result in either the great benefits or costs that some analysts predicted in the early 1990s. This is a result of other intervening events, such as Mexico's mid-1990s economic crisis, and because some important barriers to trade in farm commodities were allowed to remain in place. Growers have also been aggressive in pursuing trade remedy actions, resulting in long-running disputes over specific commodities, including Canadian wheat, cattle and swine, and Mexican tomatoes, avocados and sugar. Some of the most significant effects of NAFTA have been in the Mexican countryside, which is experiencing a great migration to urban Mexico as well as to the United States, perhaps setting the stage for major U.S. immigration reform.

In future trade agreements like the Free Trade Agreement of the Americas (FTAA), we can expect many of NAFTA's lessons to be relevant. The U.S. domestic impact of this type of regional trade agreement is relatively small, but there is potential for greater upheaval abroad, particularly in poorer countries.

These issues will be discussed in more detail during an upcoming daylong public conference sponsored by the Giannini Foundation of Agricultural Economics on

Figure 1. Total U.S. Agricultural Imports and Exports from/to Canada and Mexico: 1989-2004



Source: USDA, Foreign Agricultural Service

January 13, 2006 at the Sacramento Hilton. More information on the conference, as well as registration materials, are available at http://giannini.ucop.edu/events.htm.

NAFTA: Promise or Peril?

NAFTA aimed to liberalize trade and investment among Canada, Mexico and the United States. This regional trade agreement was expected to have a number of beneficial effects, including promoting economic efficiency throughout North America and reducing the cost of production for goods and services. With more trade and investment, the economies of all three countries were expected to grow faster, resulting in more jobs and higher incomes.

The United States and Canada negotiated a Free Trade Agreement (CUSTA) that went into effect in 1989, with little fanfare in the United States. However, this agreement was very controversial in Canada at the time. Most of CUSTA's agricultural provisions were incorporated directly into NAFTA. For example, most agricultural tariffs between the United States and Canada were phased out by January 1998, but Canada was allowed to maintain permanent tariff-rate-quota (TRQ) restrictions on imports of dairy products and poultry and eggs, while the United States was allowed to maintain TRQs on imports of sugar, dairy products and peanuts from Canada. Thus, for each country, highly protected commodities were left largely untouched by CUSTA, as the fine print of the agreement was far less radical than the title of a "free trade agreement" might suggest. Similar compromises would be made a few years later in negotiations with Mexico as part of NAFTA.

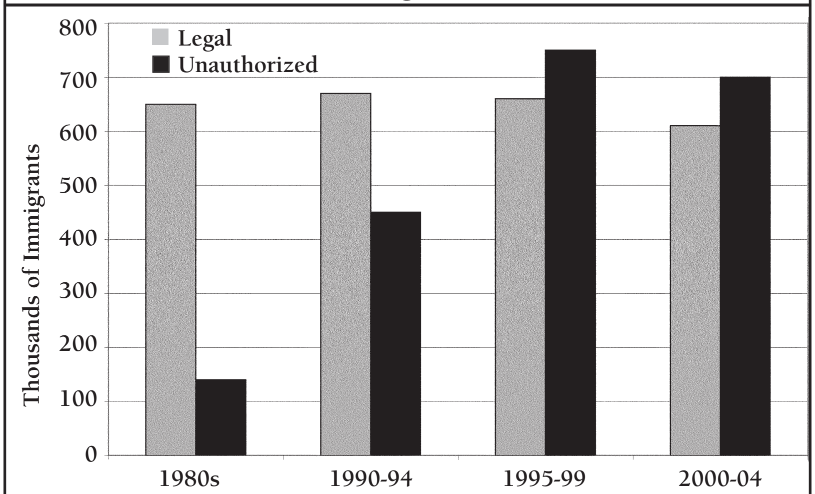
The expansion of free trade in North America to include Mexico was far more controversial in the United States than was the earlier CUSTA. As one of the first comprehensive free trade agreements between an industrial and a developing country, NAFTA aroused exaggerated hopes and fears in the United States despite the fact that the Mexican economy was about the size of Los Angeles County's. President Clinton promised that NAFTA would increase prosperity "from the Yukon to the Yucatan" while the AFL-CIO made the defeat of NAFTA its number one priority in 1993. Reform Party candidate Ross Perot warned that there would be a "giant sucking sound" of U.S. jobs fleeing to lower-wage Mexico.

There were many studies of NAFTA's likely economic effects, mostly predicting large impacts of the agreement on the Mexican economy and more modest impacts for Canada and the United States. One widely cited work, for example, concluded that NAFTA would be mutually beneficial to Mexico and the United States because increased trade would create jobs in each country. One study predicted each $69,000 of increased U.S. exports due to NAFTA would create one U.S. job, and each $11,700 increase of Mexican exports would create one Mexican job. Based on projections of $17 billion in additional U.S. exports annually to Mexico due of NAFTA, and $8 billion in additional imports from Mexico because of NAFTA, the United States was expected to gain 130,000 jobs and Mexico, 609,000 jobs. Of course, these aggregate gains masked predicted net job losses in certain sectors.

Trade liberalization means change, and many of the changes expected as a result of freer trade and investment were in Mexican agriculture. In the early 1990s, a third of all Mexicans, and two-thirds of Mexico's extremely poor, lived in rural areas and were dependent on agriculture. Falling commodity prices could potentially have had large negative impacts for these farmers if they were net sellers of crops prior to liberalization. If these growers were net buyers of food crops, or did not interact significantly with markets, falling commodity prices after NAFTA would have smaller, or even positive effects. Great effort was put into studies attempting to determine how the rural poor would be affected by changing prices for staples after NAFTA, and concerns for this population in part led to a decision to institute a 15-year phaseout of restrictions on sensitive commodities, including corn and dry beans in Mexico, and orange juice and sugar in the United States.

The market that was most sensitive in Mexico was corn, in part because of the central role of this staple in Mexican diets and culture. Corn was planted on 50 percent of Mexican farmland in the early 1990s and three million Mexicans depended at least partially on corn production, with the poorest corn farmers producing white corn used to make their own tortillas. NAFTA was expected to result in more U.S. corn shipped south to Mexico, and poor corn farmers were expected to respond by switching to produce fruits and vegetables for more affluent Mexicans and U.S. consumers. Realistic assessments pointed out that the ability of small Mexican farmers to switch to fruits and vegetables would be slow because of financial and informational constraints, as well as the fact that most Mexican fruit and vegetable production occurs in what is the U.S. off-season, except for Florida.

Figure 2. Legal and Unauthorized Immigration, Annual Averages, 1980-2004



Source: Passel, 2005

NAFTA: Trade Realities

Trade between the United States and its NAFTA partners increased sharply between 1993 and 2004—U.S. merchandise exports to Canada rose from $100 billion to $189 billion, and U.S. exports to Mexico increased from $28 billion to $111 billion. U.S. merchandise imports grew even faster: from Canada, from $91 billion to $256 billion, and from Mexico imports rose from $30 billion to $156 billion.

Agricultural trade increased as well, increasing over four-fold with Canada and Mexico (Figure 1), and hastened the integration of the North American food and fiber industry. Today, U.S. agricultural exports to Canada are diverse, led by cattle and feed; U.S. exports to Mexico are more concentrated in a few commodities, but are also led by animal feed and meat. U.S. farm imports from Canada are dominated by animals, meat and feed, while imports from Mexico are mostly fruits and vegetables that arrive in the United States seasonally.

This increase in trade was not without formal disputes. Canada uses a government state-trading agency to handle its wheat and barley exports, and U.S. grain growers believe that this government corporation trades unfairly in the U.S. market and elsewhere. A number of wheat disputes have been brought before the U.S. International Trade Commission (USITC) and, as a result, the U.S. government has imposed new tariffs against Canadian wheat. Swine farmers in the United States also sought relief from Canadian competition but they failed to convince the USITC that imports of live swine from Canada economically harmed the U.S. industry. More recently, a case of Mad Cow (BSE) Disease closed the border to imported Canadian cattle, and the United States continues to collect tariffs on Canadian softwood lumber exports from government-owned land. Canadian corn farmers are in the process of launching legal trade action against imports of U.S. corn, under the argument that U.S. corn is highly subsidized and this results in excessive exports to Canada, lowering the price in that market.

Disputes have also arisen in farm trade with Mexico that have been effectively used by growers to mitigate the impacts of increased competition as a result of trade liberalization. Mexican farmers led protests as U.S. exports of corn and other feed grains roughly doubled between 1993 and 2003, accelerating the expansion and consolidation of the Mexican pork and poultry industries, and displacing many smaller producers. Florida tomato farmers won minimum export prices for Mexican tomatoes in the mid-1990s, and California avocado growers successfully limited avocado trade, claiming that pests would accompany Mexican imports. More recently, Mexico's tax on imported U.S. corn sweeteners was declared by U.S. corn farmers to be an unlawful interference with free trade. The Mexicans imposed the tax to retaliate against protectionist U.S. sugar policy.

NAFTA: Migration Realities

Supporters of NAFTA in the United States directly linked passage of the trade agreement with the issue of illegal immigration, claiming that the jobs and higher wages that would be generated by NAFTA would eventually decrease unauthorized Mexico-U.S. migration. U.S. Secretary of State Warren Christopher, in November 1993, said: "As Mexico's economy prospers [under NAFTA], higher wages and greater opportunity will reduce the pressure for illegal migration to the United States." Former President Gerald Ford urged Congressional doubters to vote for NAFTA, saying: "If you defeat NAFTA, you have to share the responsibility for increased immigration into the United States, where they want jobs that are presently being held by Americans."

Despite these predictions, Mexico-U.S. migration did not decline after NAFTA went into effect in 1994. However, in the short run this was largely due to unforeseen events unrelated to the trade agreement. There was an economic crisis in Mexico in 1995 that led to a sharp devaluation of the peso and the disappearance of 10 percent of all formal sector jobs, prompting increased emigration. The Mexican economy recovered, but the U.S. economy also boomed in the late 1990s, helping to draw more young Mexicans to the United States to fill jobs as unemployment rates hit 30-year lows. Both the sources of Mexican migrants and their destinations in the United States expanded, so that indigenous Mixtecs from southern Mexico joined West Central Mexicans in meatpacking plants in the Midwest and poultry processing in the South. Today, Mexico-U.S. migration is at record levels, despite a tripling of the U.S. Border Patrol, and surveys find that especially young rural Mexicans see the United States as their land of opportunity. Security concerns and an economic slowdown following the terrorist attacks on September 11, 2001, have stymied efforts to develop a new immigration policy.

Despite the claims of some NAFTA advocates that the agreement would immediately reduce incentives for Mexicans to migrate to the United States, some observers did predict that adjustments in the structure of the economy of the Mexican countryside would result in a great migration off the land, with some Mexicans spilling into the United States. However, no one expected the upsurge in migration in the 1990s, the so-called migration hump, to be so large. Since 1995, unauthorized immigration, mostly from Mexico, has exceeded legal immigration from all countries.

The impact of migration flows to the United States on the Mexican economy and labor force is significant. About 10 percent of all persons born in Mexico have moved to the United States, and a quarter of Mexicans with formal sector jobs (covered by minimum wages) are employed in the United States. Mexican-born workers are 90 percent of those hired to work for wages on U.S. crop farms, and are half or more of those employed in food processing and other farm-related industries. For the past decade, unauthorized immigration from Mexico has exceeded legal immigration, making Mexicans about 60 percent of the unauthorized foreigners in the United States and 30 percent of the legal immigrants. The relevance of this experience for other countries is uncertain; few other developing countries are in the unique position of sharing a border with a country as wealthy as the United States.

Conclusions

NAFTA was neither the panacea promised by supporters nor the Pandora's box predicted by its critics, a finding that is likely to be repeated for other regional trade agreements. NAFTA clearly accelerated the integration of the economies of Canada, Mexico and the United States, leading to production specialization and lower costs due to economies of scale, as predicted by economic theory. However, there have been bumps on the road to economic integration, symbolized by ongoing disputes over wheat, corn, swine, cattle, tomatoes, avocados and sugar. Interest groups will work to protect themselves from the discipline of free trade under future trade agreements, just as they have in the case of NAFTA.

NAFTA helped accelerate the structural changes required to turn Mexico into a globally competitive modern economy and it committed Mexico's politicians to orthodox economic policies. But a free trade agreement is not a substitute for national economic development policies. Rural poverty remains a pressing concern in Mexico, as it would be in other Latin American countries if they were to liberalize trade with the United States. Moreover, the experience of China and India both show that large gains in economic growth and average incomes can be achieved without preferential trading arrangements with rich countries.

For more information on the public conference sponsored by the Giannini Foundation of Agricultural Economics on January 13, 2006, see the box on page 8.

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performance may be partially explained by its general-purpose attributes. Because the purchase of a computer is a fixed cost, and Internet access is typically priced at a flat rate, business and personal use may be too intertwined to distinguish effectively. If a farmer already has a computer with Internet access for personal use, the marginal cost of performing some business applications on the Internet is close to zero. Such a farmer is therefore more likely to use the Internet to gather, for example, business-related information even if the financial benefits of this information are negligible. This argument applies equally well to California farmers, for whom overall computer-use rates do not differ substantially from the rest of the country (Figures 1 and 2).

Perceived benefits of Internet use for farm business will likely increase as more farmers move up the learning curve, as the technology becomes more pertinent to farm business, and as new applications and services become available. For example, voice over Internet Protocol (Voice over IP) will eliminate long-distance charges, and wi-fi wireless networks will permit mobile Internet applications on the farm. Such applications will be particularly useful in helping the industry to track produce from planting to the store. Further research tracking these changes and better identifying and distinguishing both business and non-business benefits of farm Internet use seem particularly important for understanding how the technology might change farm production processes and competitiveness in the future.

For more details on the use of computers and the Internet in agriculture, the authors recommend the following reading:

Smith, A., W.R. Goe, M. Kenney, and C.J. Morrison Paul, "Computer and Internet Use by Great Plains Farmers," *Journal of Agricultural and Resource Economics*, 29(3):481-500, 2004.

USDA National Agricultural Statistics Service Report, "Farm Computer Usage and Ownership," available at http://usda.mannlib.cornell.edu/reports/nassr/other/computer/.

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(Continued from page 4)

North American Agriculture: Ê Assessing NAFTA at 12 Ê

Friday, January 13, 2006 Ê

Sacramento Hilton, 2200 Harvard Street
tel 916-922-4700 Ê

AGENDA

8AM: *Registration and continental breakfast*

9AM: *Welcome and Introduction,*
David Zilberman, UCB

9:15: *Assessing NAFTA, CAFTA, and the FTAA.* Ê
Chair, Philip Martin, UCD Ê
Gary Hufbauer, Institute of International Economics
Discussants, Ann Harrison, UCB
Rob Feenstra, UCD

10:15: Coffee break

10:30: *Trends in Specific Commodities*
Chair, David Zilberman, UCB
Canada-U.S. Trade, Colin Carter, UCD
Mexico-U.S. Trade, Steve Zahnheiser, USDA
Discussant, Roberta Cook, UCD

12PM: *California in the 21st Century* Ê
Lunch with Dan Walters, *Sacramento Bee* Ê

2PM: *NAFTA's People Impacts* Ê
Chair, Colin Carter, UCD Ê
Mexico-U.S. Migration, Ed Taylor, UCD
Impacts of Mexican Migration, Ê Philip Martin, UCD
Discussant, Alix Peterson Zwane, UCB

3:30: Coffee break

3:45: *What Can Agriculture Expect from Doha?*
Jason Hafemeister, Director for WTO Agricultural Negotiations, U.S. Trade Representative's Office Ê

4:30PM: Adjourn Ê

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The registration fee is $75, which includes meals and conference materials; registrations received will be acknowledged with receipts and conference materials. If you would like to participate, please send a check made payable to UC Regents *before December 13, 2005 to:* Ê

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Rooms can be reserved at the Sacramento Hilton at the special rate of $84 plus tax, by using the UC-Giannini Group, code SDA. Rooms must be reserved by December 20, 2005.

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For additional information on the conference and the registration process, visit the Giannini Foundation Web site at Ê http://giannini.ucop.edu. Ê