

NAFTA: Implications for Mexican and Midwestern Agriculture

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WHAT HAS BEEN HAPPENING SINCE 1994?

The North American Free Trade Agreement (NAFTA) is a success story of economic integration between Mexico, the United States, and Canada. Economic integration was on its way before the Agreement, but it received a significant boost when NAFTA went into effect in 1994. Relative to the rest of the world, merchandise trade among the three countries has intensified and is growing at a rate of about 10 to 12 percent a year. With respect to agriculture, Mexico exports fruits and vegetables, coffee, live cattle, and textiles, among other things, to the United States. The United States exports grains and feed (90 percent of Mexican imports), soybeans and soybean products, meat, cotton, yarn, and textiles to Mexico. Tariffs have disappeared or have been decreasing between Mexico and the United States (there is no tariff, for example, on Mexican imports of U.S. and Canadian non-breeding cattle and beef).

NAFTA and trade integration have given a boost to real income growth in Mexico (5 percent a year, on average, since 1994, excluding the 1995 crisis). There is a growing middle class of 30 million people consuming more and more expensive food. The United States has had stabilizing effects on Mexico, both financially, as in the 1995 crisis, and by providing large markets for Mexican exports when home consumption has been depressed. The United States is benefiting from this large and growing (in income and population) food market. The rapid emergence of supermarkets in Mexico is evidence of such growth.

Because trade integration has brought demographic and cultural changes to the United States, and because health information is improving, U.S. consumers eat more vegetables, fruits, and ethnic foods than before. This provides a large market for Mexican agriculture and food processing. This trade is seasonal but could be expanded, especially if some joint policies that maintain prices above free market prices (the so-called minimum prices) were removed.



In the last decade, Mexico has been privatizing many segments of the food marketing system—from the farm, to the warehouse, to the consumer's table. Private investment (Mexican and foreign) in food marketing is increasing, and efficiency gains (in food quality and vertical integration/coordination, for example) are coming. This positive change has occurred despite the presence of strong labor unions and vested political interests in the status quo. New supermarket chains are a major force in Mexico's reliance on market forces.

Increased mobility of capital between the two countries is a reality. U.S. investment in Mexican food processing has increased significantly (it grew to \$5 billion in 1997) but is still relatively modest. Foreign direct investment (FDI) in food processing is accompanied by contract agriculture. Large Mexican food processors have opened plants in the United States (corn mills Gruma, GIBSA, and Minsa in Iowa, for example). Mexican FDI in U.S. food processing amounted to \$313 million in 1997. Mexico is also more open to third-country investment (such as Scandinavian investment in dairy processing).

NAFTA is also an innovator in the area of trade dispute settlement mechanisms. These mechanisms are notoriously slow within the World Trade Organization (WTO). NAFTA is developing private dispute resolution capacity. The Advisory Committee on Private Commercial Dispute Regarding Agricultural Goods is supported by growers and shippers and appears to be a promising venue for dispute resolution. In the area of Sanitary and Phytosanitary (SPS) measures, the NAFTA Committee for SPS facilitates technical cooperation and information flows between countries. This cooperation decreases the cost of institution-building in Mexico and reduces the likelihood of SPS disputes.

MEXICAN FOOD TRADE AND CONSUMPTION PATTERNS: HISTORY AND OUTLOOK

Figures 1–3 and Table 1 show the evolution of grain, oilseed, and meat consumption and trade in Mexico. The figures show 10 years of historical data (1990–99) and 10 years of outlook (2000–2009) based on the Food and Agricultural Policy Research Institute's *2000 World Agricultural Outlook*. Grain food

consumption is maturing, while meat consumption is increasing relatively rapidly. The latter observation means that imports of meat by Mexico have been growing and will continue to grow, and that feed demand in Mexico will also increase, translating into increased feed grain and soybean meal imports from NAFTA partners (see Table 1).

Diet diversification is occurring on both sides of the border, although at different income levels. This diversification means limited growth prospects for U.S. food grain exports to Mexico. Food grain is a maturing food market in the medium run. Lower tariffs through NAFTA (to be fully phased out by 2008) and population growth will provide some increases in food grain trade; however, income growth in Mexico is not expected to contribute to food grain market growth.

Meat consumption in Mexico is increasing rapidly and is projected to continue to do so in the coming decade. Mexico is the second largest export market of U.S. meat products (\$900 million of U.S. meat exports including \$231 million of poultry meat and \$398 million of beef and veal in 1998). Also note that U.S. feed grain demand is embodied in U.S. meat exports to Mexico. The prospects for feed demand are much better than those for food grain demand.

With rising income, the demand for food quality increases rapidly. Consumers tend to spend more on higher quality and convenience foods rather than on larger quantities of bulk goods. This change is reflected in the market for raw agricultural commodities. Hence, U.S. exporters should be sensitive to this demand for higher quality of commodities. Tenders/contracts for grains can specify quality levels. The same argument applies for Mexican producers. Concern for quality will remain high. Achieving higher quality standards is costly and is characterized by economies of scale. For example, grading and sort-

ing have lower cost per unit in large operations.

CHALLENGES AHEAD

The U.S.-Mexico economic integration faces impediments in transportation services, though free trade in transportation services should have been in place by now. Trucks, which carry about 80 percent of traded goods, still have constrained access (drayage across the border). Mexican trucks are constrained in the United States because of protectionism but also because of safety concerns (heavier and older Mexican trucks compared to U.S. trucks and no driving time restrictions for Mexican drivers). The recent NAFTA arbitration panel decision in favor of Mexico should bring major changes. In addition, many delays exist in both directions. Delays make fresh products vulnerable but are less of a prob-

lem for grains. Rail and ocean shipments are used more frequently for the latter (for example, New Orleans and Galveston to Veracruz). Rail infrastructure is improving in Mexico, sometimes via international cooperation (such as the "NAFTA Railway" alliance), but more needs to be done. The Mexican railway system is still undercapitalized, because of past neglect

TABLE 1. ANNUAL RATE OF GROWTH

Imports	90-99	00-09
Corn	10.70%	2.77%
Soybean	11.62%	1.49%
Soybean meal	-5.25%	17.29%
Soy oil	2.16%	6.51%
Beef & veal	16.83%	3.22%
Pork imports	19.58%	4.12%
Poultry meat	15.87%	5.69%
Consumption and Utilization Data		
Feed use corn	19.34%	3.07%
Food and other use of corn	1.15%	1.02%
Soybean domestic use	7.03%	1.43%
Meal domestic use	6.83%	2.75%
Domestic oil use	6.28%	2.12%
Beef & veal	0.83%	2.52%
Pork	2.78%	3.49%
Broiler	7.05%	2.46%

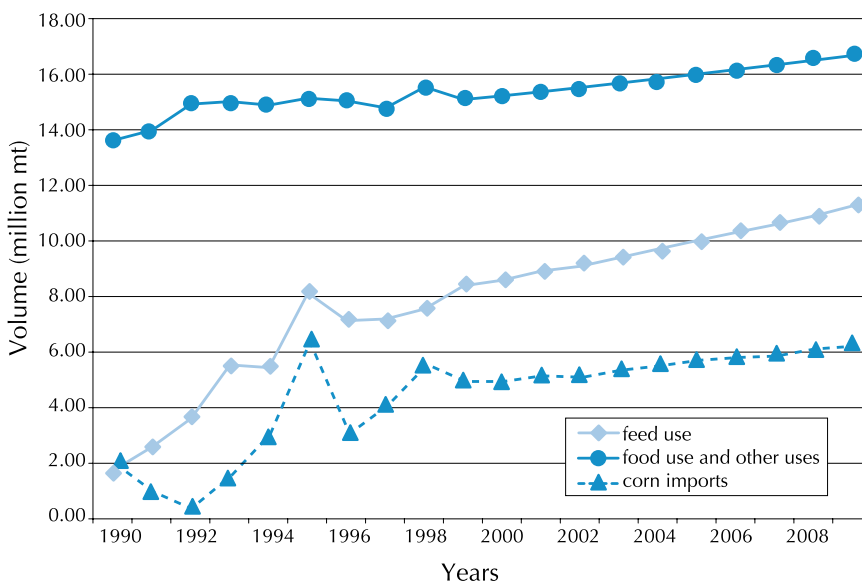


FIGURE 1. MEXICAN CORN USE AND IMPORTS

prior to privatization. For example, intermodal connection with trucking and ocean shipping is lacking, and better connections would increase the relative advantage of railways. Larger and better facilities would help alleviate some of the bottlenecks at border points. More customs personnel would help, too. Finally, Mexico has yet to build better roads to be on a par with U.S. roads. This improvement would benefit Mexico at large. Road-building projects tend to have high social returns.

Despite progress in freeing markets, Mexico still subsidizes the production of corn through input subsidies (the ASERCA program under the 1996 ALIANZA umbrella program, for example), historical entitlements (such as the 1993 PROCAMPO program), and border taxes and restrictions. Also, Mexican Tariff-Rate-Quota (TRQ) levels have been flexible or have not been enforced when local market conditions dictated. For its part, the United States distorts domestic and world markets for corn and soybeans through the loan rate, effectively depressing world prices, and through “emergency” payments, insurance subsidies, and “decoupled” Agricultural Market Transition Act payments. Mexican farmers received \$44/hectare of income transfer (all crops) in 1997–99, and U.S. farmers received about \$85/hectare of income transfer (all crops) for the same time period. The corresponding average for all 29 Organization of Economic Cooperation and Development (OECD) countries was \$211/hectare. For corn and oilseeds, the level of income subsidy (as a percentage of price received) was comparable: 30 percent and 25 percent of producer price for corn and soybeans in the United States (computed *without* the 1999 emergency packages); 39 and 36 percent of producer price in Mexico, respectively, for 1997–99. Mexican consumers of tortillas used to be subsidized but are now taxed. The former

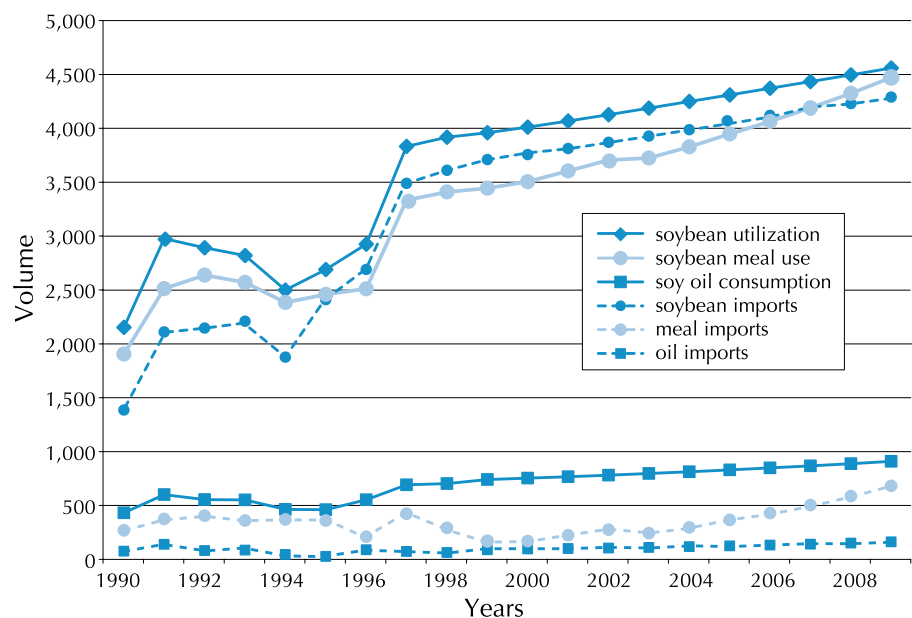


FIGURE 2. MEXICAN SOYBEAN PRODUCT USE AND IMPORTS (1000 MT)

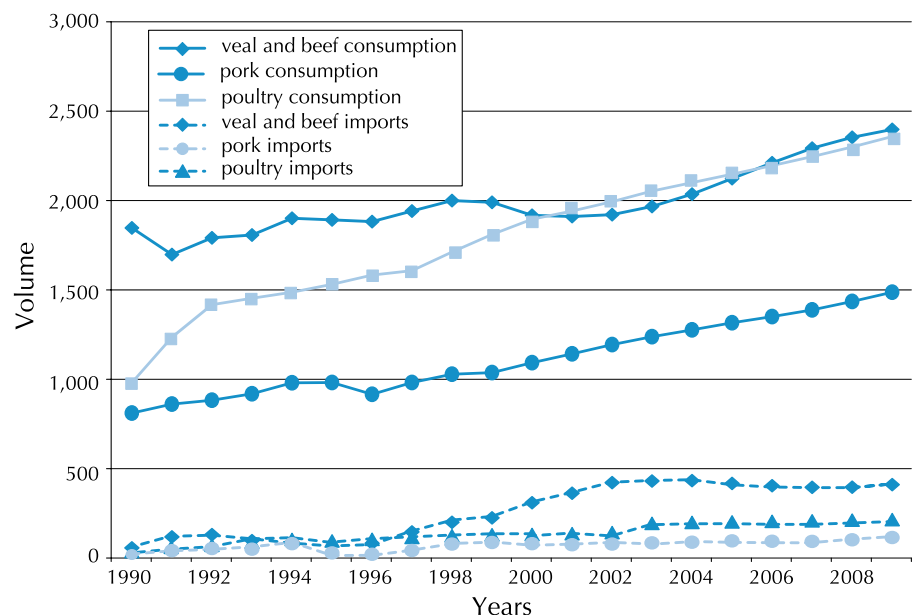


FIGURE 3. MEXICAN MEAT CONSUMPTION AND IMPORTS (1000 MT)

parastatal agency, CONASUPO, had reduced tortilla consumption subsidies and then eventually closed. New targeted programs, such as the SEDESOL program, subsidized corn consumption by poor households. On average, Mexican consumers face an implicit tax of 21 percent on tortillas, in reference to an undistorted market price, as of 1999.

NAFTA has induced SPS-based trade disputes. Phytosanitary measures are often based on legitimate concerns for health and/or the environment, but they induce disputes that are difficult to resolve. Occa-

sionally they are used for protectionist purposes. The increased cooperation between the United States and Mexico should help to resolve these SPS frictions. There is evidence of goodwill on both sides (for example, the United States' willingness to recognize improvements in poultry SPS status in Sonora).

NAFTA STORY STILL UNFOLDING

To conclude, NAFTA is a success story for agriculture-related trade and industry, although the success is not complete, because of trade disputes, transport congestion at the

border, insufficient infrastructure, remaining policy distortions, and uneven economic integration in Mexico. The continuing diversification of consumers' diets and rising income in Mexico are expected to translate into limited growth prospects for U.S. food grain exports to Mexico and increased growth prospects for feed and meat trade. ♦

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