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North American free trade: a strategy for California agriculture

Congress' recent two-year extension of the President's "fast-track" trade negotiation authority sets the stage for serious discussion of a North American Free Trade Agreement (NAFTA), to include Canada, Mexico, and the United States. With a free trade agreement between Canada and the United States already in place, much of the interest in NAFTA is focused on the implications of U.S.-Mexico free trade. This is particularly so in California, especially in agricultural circles where trade relationships in products, capital, and labor markets are already well established.

Although Mexico's economy is small compared to that of the United States, (its gross domestic product equivalent to 3.6% of ours), Mexican-U.S. trade is substantial. After Canada and Japan, Mexico is our third largest trading partner, providing 6% of total U.S. imports and purchasing 7% of U.S. exports. Those U.S. exports, however, account for nearly two-thirds of all Mexican imports. For California, Mexico is our third largest market, with trade between us growing rapidly.

Most of the studies conducted to date draw two major conclusions. First, a U.S.-Mexico free trade agreement would benefit the U.S. economy overall. However, those benefits are likely to be small in the near to medium term for two reasons: the small size of the Mexican economy relative to the U.S. and the fact that with few exceptions both countries already have relatively low tariff and nontariff barriers to trade with each other.

The second conclusion is that there will be uneven effects across sectors, particular markets, and regions — typical of any economy-wide adjustment in trade policy. The U.S. International Trade Commission (ITC) concludes, for example, that a U.S.-Mexico free trade agreement would likely have negligible effects on domestic operations of 17 of the 19 U.S. industries studied. Impacts (positive and negative) in the states bordering Mexico likely would be more immediate and pronounced. And, of course, impacts of free trade would be larger in those sectors and markets where tariff and nontariff barriers are highest — as in agriculture, auto and energy products, banking, and transport.

Agriculture illustrates the potential complexity and uneven effects of a U.S.-Mexico free trade agreement. Mexico is the second largest provider of U.S. agricultural imports after Canada and the third largest customer for U.S. agricultural products after Japan and the Soviet Union. About 40% of U.S. agricultural imports from Mexico enter duty-free, the remainder at a dutiable trade-weighted average of 7% ad valorem. Mexico's trade-weighted duty on U.S. agricultural products averages 11%. As is customary in agricultural trade, each country maintains an array of nontariff barriers including Mexican import-licensing requirements, U.S. marketing orders, and phytosanitary regulations in both countries.

About two-thirds of U.S. agricultural exports to Mexico consist of grains and oilseeds. Given U.S. dominance in production of these commodities, a free trade agreement is likely to benefit Midwestern producers of corn, sorghum, and soybeans. In the case of livestock, removal of Mexico's relatively high tariffs on meat would benefit U.S. cattle feeders and meat packers in areas such as Texas, the Midwest, and, to some extent, California. Removal of U.S. duties and Mexican export fees on feeder cattle, however, could negatively affect cow-calf operations concentrated in the Southwest and South Central states.

The U.S. agricultural industries most at risk in a U.S.-Mexico free trade agreement are the fruit and vegetable industries. The implications for California agriculture are obvious. Relatively high duties are levied by both countries; phytosanitary and other nontariff barriers are used extensively by each country with trade-restricting results. But even in this instance, the impacts would be uneven. California producers of citrus, avocadoes, and winter vegetables would face stiffer competition in both domestic and Canadian markets. On the other hand, California processors of deciduous fruit, the wine industry, and producers of high-value and value-added specialty products might gain from economic growth and an expanded market in Mexico.

These examples illustrate the complexity and tradeoffs inherent in trade negotiations and the fact that an agreement creates gains and losses and a consequent uneven distribution of benefits and costs among and within sectors, regions, and particular markets. The provisions of any agreements which might be attained in a U.S.-Mexico free trade agreement likely would be phased in over a period of years which, coupled with possible adjustment assistance, would permit negatively impacted sectors to mitigate what otherwise might be substantial short-term adjustment problems.

Some California agricultural interests are on record in opposition to a U.S.-Mexico free trade agreement for reasons alluded to above. Beyond potentially negative impacts on markets for some fruits and vegetables, other concerns turn on the potential impacts on agricultural labor markets, possible acceleration of agricultural investment capital flows from California into Mexico, technology transfer and protection of intellectual property rights in Mexico, and the possible discriminatory economic effects on California producers of differing food safety and environmental regulations in the two countries. Although outcomes are uncertain, each of these concerns is likely to be the subject of special consideration in the course of negotiations.

Because both countries on balance stand to gain economically, with somewhat larger net gains accruing to Mexico, there is a high probability of eventual enactment of a free trade agreement. From a U.S. and California perspective, a free trade agreement which eliminates trade barriers and stimulates more efficient use of resources in each country is in our long-term economic and political interests. Coupled with structural reform and open, trade-oriented domestic economic policies in Mexico, a free trade agreement could stimulate a "rising tide" of economic growth in Mexico to the advantage of both countries.

As in negotiation of the U.S.-Canada free trade agreement and in the multilateral General Agreement on Tariffs and Trade (GATT) negotiations, agriculture will receive special attention in the U.S.-Mexico negotiations. The best strategy for California agricultural interests is to ensure that the "playing field" is as level as possible, that trade adjustments are phased in gradually, that "snapback" provisions are included to guard against sudden, unanticipated market-disrupting impacts, and that effective mechanisms are created for arbitration of trade disputes as in the Canada-U.S. free trade agreement.