

Is NAFTA Good or Bad?

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The North American Free Trade Agreement (NAFTA) was signed in December 1992. After Congressional approval, NAFTA will go into effect January 1, 1994. NAFTA comprises two bilateral agreements on market access — one between the United States and Mexico and the other between Mexico and Canada. The 1989 Canadian-U.S. Free Trade Agreement (CUSTA), which governs trade between the United States and Canada, also is incorporated into NAFTA. The agreement would create the largest single market in the world, representing 350 million consumers and trade valued at over \$230 billion. The objective of the economic integration is to stimulate economies of the participating countries through trade expansion among the countries.

Economic Characteristics

While the United States and Canada are similar in terms of resource endowments, Mexico differs from its two

trading partners. Per capita gross domestic product (GDP) in Mexico is approximately one-tenth of that in the United States and Canada. Farm population is 27.6 percent of the total population in Mexico and is less than 2.5 percent in the United States and Canada. Per capita farmland in Mexico (.7 acres) is smaller than the United States (1.9 acres) and Canada (4.6 acres).

Bilateral trade patterns between the United States and Mexico differ from those between the United States and Canada, mainly because of differences in resource endowments between Mexico and Canada. Bilateral trade value between the United States and Canada is \$180 billion and that between the United States and Mexico is \$50 billion (Figure 1). The value of agricultural products traded between the United States and Canada is about 3 percent of the total trade value, while that between the United States and Mexico is about 8 percent.

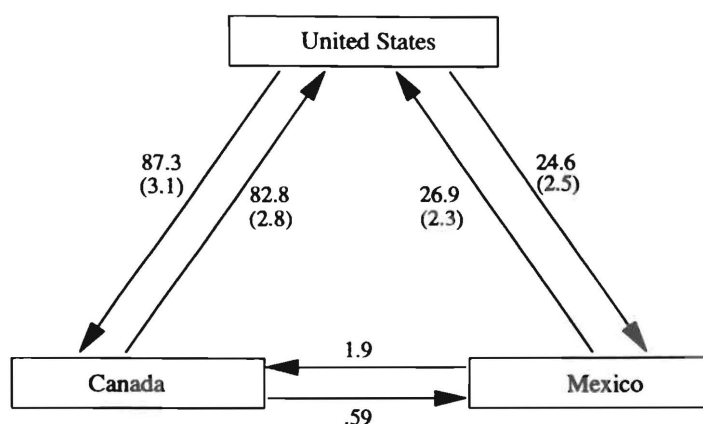


Figure 1. United States, Canadian and Mexican trade flow (average, 1989-1991). Total trade in billion U.S. dollars, agricultural trade in parenthesis.

Major U.S. exports to Canada are inedible end products (70 percent) followed by fabricated materials (19 percent) (Figure 2) and those to Mexico are machinery and transportation equipment (47 percent) (Figure 3). On the other hand, machinery and equipment are the major U.S. imports from Canada (46 percent) (Figure 4) and Mexico (47 percent) (Figure 5).

The United States exports vegetables and fruits (38 percent), meat/poultry (13 percent), and feed and protein meal (10 percent) to Canada and exports coarse grain (21 percent), oilseed (12 percent), and meat/poultry (10 percent) to Mexico. U.S. imports from Mexico are fruit and nuts (37 percent), coffee (13 percent), wine and malt (6 percent), and sugar (1 percent). U.S. imports from Canada are meat products (20 percent), grain (17 percent), oilseed (8 percent), and wine and malt (6 percent).

Contents of NAFTA

NAFTA will create a free trade area by eliminating border protection on all agricultural and nonagricultural products among the three countries. NAFTA is established under GATT Article XXIV, which prohibits any FTA from having higher or more restrictive duties to the third party countries than those existing before its formation.

The Canadian-U.S. FTA began to eliminate most tariff barriers between the two countries in January 1989. Nontariff barriers, which were converted to tariffs, are being phased out over the transition period in three different categories.

The first set of tariffs was eliminated January 1, 1989, for a group of goods that make up 15 percent of dutiable bilateral trade: animal feeds, leather, and fur goods.

The second set of changes calls for tariffs to be phased out over five years in equal annual installments of 20 percent. The goods in this group require a period of adjustment and constitute about a third of the bilateral trade subject to duties: hardwood, plywood, and some meat.

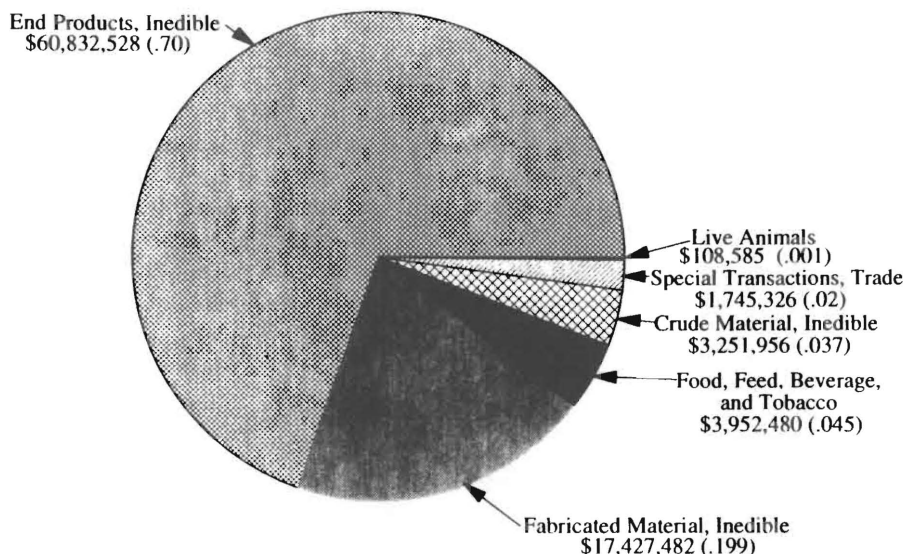


Figure 2. United States exports to Canada by commodity groups (average, 1989-1991) \$1,000 (percent of total exports in parenthesis).

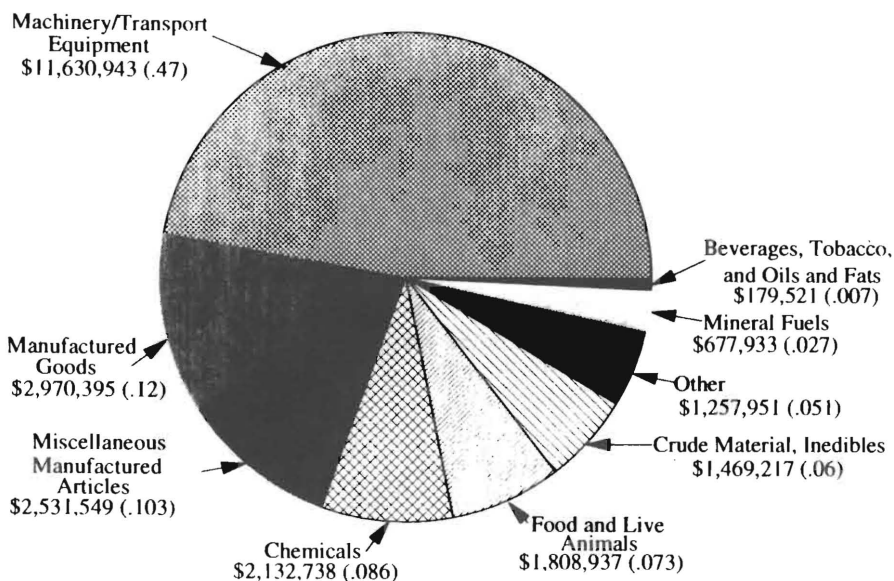


Figure 3. United States exports to Mexico by commodity groups (average, 1989-1991) \$1,000 (percent of total exports in parenthesis).

The third set of tariffs will be eliminated in 10 annual installments of 10 percent. This group accounts for half of the bilateral trade subject to duties. Most agricultural products belong to this group.

Similarly, all tariffs and nontariff measures that influence trade of agricultural products between the United States and Mexico will be eliminated over a

specified transition period (5 to 15 years) under NAFTA. Most nontariff barriers will be converted to tariff-rate quotas, under which a certain quantity of the product will enter duty free, while anything over this amount will be subject to the average 1989-91 tariff-equivalent border protection.

Mexico's nontariff barriers are largely import licenses. Import licenses for

wheat, grapes, tobacco, condensed milk, cheese, and day-old chicks will be converted to tariffs and phased out over 5 to 15 years. Import licenses for corn, dry beans, milk powder, poultry, barley/malt, animal fat, potatoes, and eggs will be converted to tariff-rate quotas and phased out over the transition period. The Mexican and Canadian bilateral agreement will eliminate most trade restrictions for all

manufactured and agricultural products, except dairy, poultry, and sugar.

U.S. nontariff barriers are import quotas on dairy products, sugar, and peanuts. The import quotas on these products from Mexico will be converted to tariff-rate quotas and will be phased out over the transition period: dairy products and sugar over 10 years and peanuts over 15 years.

Potential Impacts

Considering differences in resource endowments between Mexico and the United States or Canada, the FTA will affect the bilateral trade relationship between the United States and Mexico more than that between the United States and Canada. The FTA could increase trade volume between the United States and Canada through competition. Both countries produce similar products and compete with each other. However, commodities produced in Mexico differ from those produced in the United States. The United States will have a comparative advantage over Mexico in producing technology and capital-intensive products, while Mexico will have a comparative advantage over the United States in producing labor-intensive products.

Many U.S. firms will use Mexico's cheap labor to be competitive in the global market. In the short run, jobs that require unskilled labor will be moved to Mexico, increasing U.S. unemployment rate. However, using cheaper labor will make U.S. industry more competitive, implying increased exports, which stimulate the U.S. economy and eventually create more jobs that require skilled labor in the United States.

NAFTA will also result in U.S. imports of labor-intensive products from Mexico, replacing the products from other countries. Similarly, Mexico could replace its imports of technology-intensive products from other countries with products from the United States. This effect may not be significant in the trade between the United States and Canada. The FTA between the United States and Mexico, therefore, could affect U.S. imports from developing countries.

Trilateral agricultural trade accounts for less than 5 percent of the total trade value (\$12 billion), mainly because these countries use higher protection for agricultural products than for manufactured products. Eliminating trade barriers under NAFTA, therefore, could increase agricultural trade significantly. U.S. agricultural exports to Mexico have grown significantly since the mid-1980s, rising

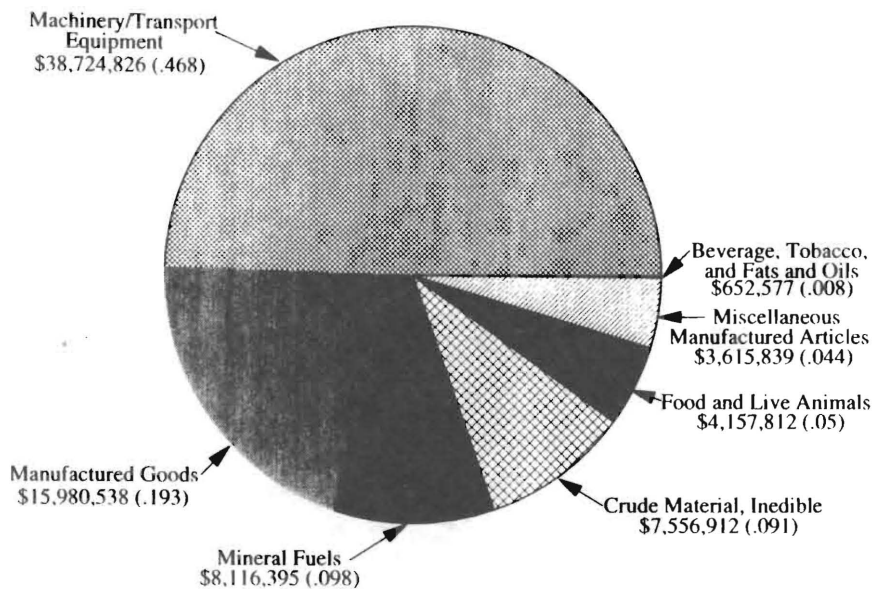


Figure 4. United States imports from Canada by commodity groups (average, 1989-1991) \$1,000 (percent of total imports in parenthesis).

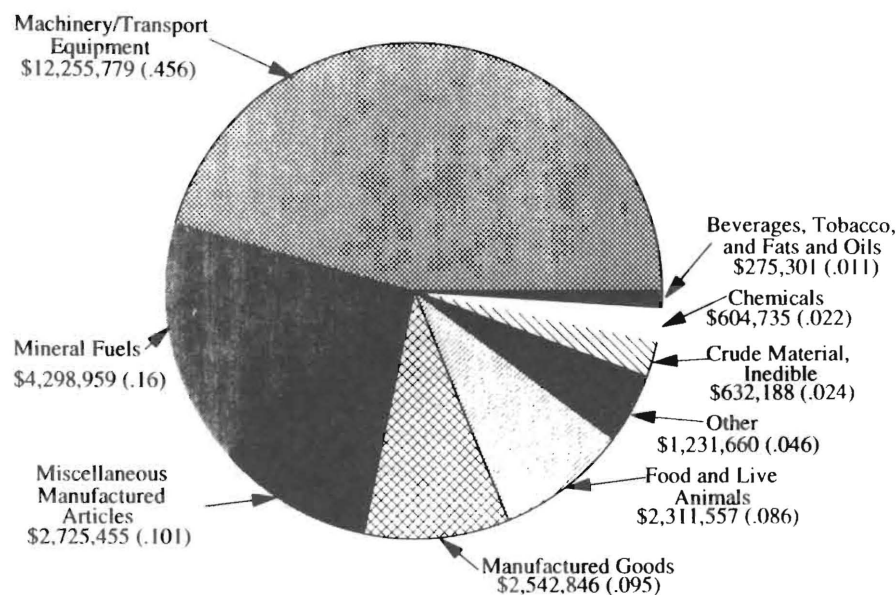


Figure 3. United States exports to Mexico by commodity groups (average, 1989-1991) \$1,000 (percent of total exports in parenthesis).

from \$1.4 billion to \$3.0 billion in 1991. NAFTA will assure that this growth in U.S. agricultural exports to Mexico continues.

The agreement could also change the structure of production (i.e., output mix) in individual regions that were established over the last several decades on the basis of resource endowments. This is especially true for border states with Canada (North Dakota, Montana, Minnesota, Wisconsin, Michigan, and Washington) and Mexico (Texas and California). Agricultural products which NAFTA will affect include hard red spring wheat and wheat flour, durum wheat and semolina, barley, corn, oilseed, beef/cattle, poultry, and fruits/vegetables. The impacts on selected commodities are as follows.

Grains and Oilseeds

The United States could increase corn exports to Mexico and Canada under NAFTA. Mexico will convert its import licensing regime for corn imported from the United States and Canada to tariff-rate quota (TRQ) under NAFTA. For the United States, duty-free access to the Mexican market will be assured for 2.5 million metric tons of corn. The TRQ will grow at a 3 percent annual compounded rate over 15 years. U.S. exports to Mexico over 2.5 million metric tons will have a tariff of 215 percent, but the tariff will be reduced to zero over 15 years. Corn is a food grain in Mexico. Corn Belt states could expand their exports of corn to Mexico. North Dakota could export corn to Canada, mainly because of North Dakota's transportation advantage over Corn Belt states.

U.S. sorghum exports to Mexico will increase because of the immediate elimination of the sorghum tariff.

U.S. wheat exports will increase under NAFTA because of the elimination of tariffs and licensing and higher Mexican incomes. U.S. wheat exports to Mexico are expected to grow from 1 to 1.5 million tons per year within a decade (U.S. Department of Agriculture). On the other hand, wheat trade between the United States and Canada could be small under NAFTA.

Table 1. Characteristics of the participating countries.

	U.S.	Canada	Mexico
Population (million)	248.2	26.4	84.5
Per capita GDP (\$)	20,756.0	24,662.0	2,375.0
Population in agriculture (%)	2.5	1.6	27.0
Arable land (million acres)	465.0	122.0	57.3
Per capita arable land (acres)	1.9	4.6	0.7
Average age (years)	32.0	32.8	22.0
Education (years in school)	11.0	12.0	7.5

North Dakota has a comparative advantage over Canada in producing durum and semolina. Canada, however, is exporting durum wheat to the United States, mainly because of the Canadian rail subsidy program for grain moving to Thunder Bay and the U.S. EEP. The Canadian rail subsidy program has made Canadian grain more competitive with the United States in shipping agricultural commodities to the eastern United States. On the other hand, the U.S. EEP program has raised the price of durum wheat in the United States and lowered world prices. As a result, Canada tends to export to the United States to get high prices.

The impacts of NAFTA on the spring wheat industries in the two countries are not significant. Trade flows of spring wheat between the United States and Canada do not exist. However, Canada has a comparative advantage over the United States in some Asian markets because distances between Canadian producing regions and the west coast are shorter than distances in the United States. This implies that worldwide free trade under GATT influences trade flows of spring wheat more than NAFTA does.

Mexico will reduce its 15 percent seasonal duty on soybeans to 10 percent, which will be phased out over 10 years. Mexico's demand for grains and oilseeds is expected to increase as its livestock and poultry sectors expand.

Livestock and Meat

The agreement will affect trilateral trade flows of beef/cattle. The United States imports live cattle from Canada and Mexico and exports beef to both countries. The agreement will enhance the trade relationship. If NAFTA is fully implemented, broiler production capacity in the United States may not be large enough to meet demand for broilers in Canada and Mexico. The Upper Great Plains states especially need more production capacity to meet the demand for broilers in the northwestern United States, and western Canada and Texas need more production capacity to meet the demand in Mexico.

Sugar

The agreement on sugar is as follows (U.S. Department of Agriculture): 1) In the initial six years of the agreement, Mexico's sugar exports to the United States will be limited to its current allocation of 7,258 metric tons. However, in any year that Mexico reaches net exporter status during the initial six-year period, it would be allowed access for its net exportable surplus up to 25,000 metric tons. 2) Beginning in year 7, Mexico will be allowed to ship its net exportable surplus to the United States up to a maximum of 150,000 tons. This ceiling will grow 10 percent per year over the remainder of the 15-year transition. 3) If Mexico reaches net exporter status for two consecutive years at any time during the transition period, beginning in year 7 or the second year of net export status, whichever is later, it can ship its total exportable surplus to the United States duty free.

Per capita sugar consumption in Mexico (48.3 lbs) is larger than that in the United States (31.8 lbs) and Canada (33.2 lbs). These three countries are net sugar importers; the United States imported 2.6 million metric tons in 1990, Mexico 1.5 million metric tons, and Canada 873 million metric tons. Domestic production of sugar is 6.7 million metric tons in the United States, 3.4 million metric tons in Mexico, and 138 thousand metric tons in Canada.

To be self-sufficient, Mexico would have to increase sugar production over 15 percent to meet the current consumption of 4 million metric tons. Even if Mexico gains a net exporter status by increasing sugar production beyond the consumption level, Mexico's exports to the United States could be insignificant, mainly because 1) Mexico may have a limited capacity for producing sugar and 2) Mexico may have greater advantage in producing fruits and vegetables rather than sugar under NAFTA.

Mexico could import corn sweetener from the United States to use for beverage production. In this case, domestic production of cane sugar may exceed its domestic production and Mexico could export its surplus sugar production to the United States. However, increases in sugar imports from Mexico would not substantially affect the U.S. sugar industry, mainly because the U.S. import quota would include NAFTA signatories.

Concluding Remarks

Although NAFTA will stimulate the economies of the participating countries, it will affect the bilateral trade relationship between the United States and Mexico more than that between the United States and Canada. U.S. manufacturing industries will be more competitive in the global market because the industries have access to cheaper labor in Mexico under NAFTA.

In addition, the United States could have a comparative advantage over Mexico and Canada in producing technology and capital-intensive products, while the United States could import more labor-intensive products from Mexico and raw materials from Canada. The food processing industry is technology and capital intensive; the United States has a comparative advantage over Canada and Mexico in producing and exporting value-added agricultural products.

The United States could increase its exports of corn, soybeans, sorghum, and meat to Mexico and feed grains and meals and meat to Canada. NAFTA will not substantially affect the trade relationship of wheat and sugar among the countries.

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