NAFTA: A Win-Win Proposition for U.S. Producers

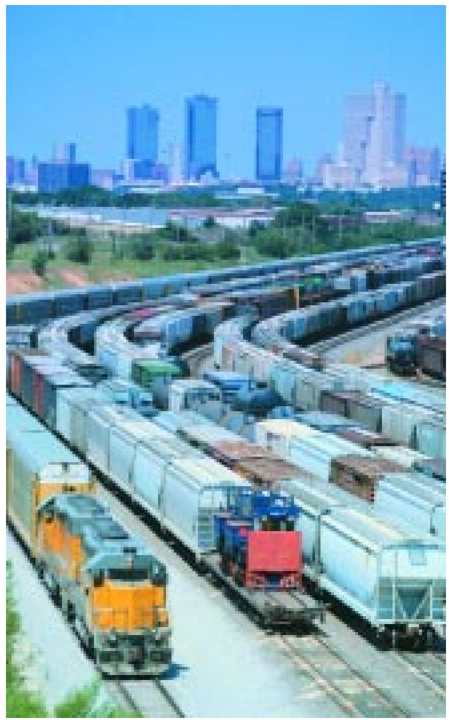
To get an overall picture of how well NAFTA (the North American Free Trade Agreement) has worked, **AgExporter** *interviewed Michael Dwyer, chief economist with FAS' Commodity and Marketing Programs area. Here are his insights on NAFTA's overall impact on U.S. agricultural trade, and on the economic fundamentals and comparative advantages that will shape future commerce trends among the three partners.*

AgExporter: What do you think NAFTA has done for U.S. agricultural trade with Canada and Mexico? How do you see its future?

Michael Dwyer: While there have been bumps in the road, a review of the past 10 years shows that NAFTA's success has been quite remarkable for U.S. agriculture. Overall, worldwide U.S. agricultural exports rose by about $6.9 billion between 1994 and 2002. Of that, $5.8 billion has been to Canada and Mexico. It's hard to overlook those statistics. With fewer trade barriers and food demand continuing to expand, particularly in Mexico, the future of U.S. exports to our NAFTA partners also looks outstanding.

Since 1994, Canada and Mexico have been our two top growth markets in the world–by a wide margin. Exports to Canada rose by about $3.1 billion over those years, while sales to Mexico rose about $2.7 billion. U.S. exports to the rest of the world rose by only $1.1 billion.

In the case of Canada, 70 percent of our exports are in the consumer-oriented HVP (high-value product) category. This



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includes horticultural products, meat and dairy products, snack foods, beverages and other grocery products. Corn and soybeans are the main export items in the smaller bulk commodity category. Most of these products have grown sharply since the U.S.-Canada Free Trade Agreement and NAFTA were signed. In fact, exports of many items are currently at record highs.

Exports to Mexico are more diversified than they are to Canada–with 39 percent being bulk commodities, 39 percent consumer-oriented HVPs and 22 percent intermediate HVPs (semi-processed products). Mexico is one of our largest export markets for each category. Growth in corn, soybean and wheat exports has done particularly well. Growth in cotton sales to Mexico has also been very impressive, due to the country's rising consumer and export demand for its textiles and apparel.

However, the biggest surprise has been the strong growth of many of our consumer-oriented HVPs to Mexico. Before NAFTA, U.S. exports of these products were severely limited by trade barriers and weak demand. Today, courtesy of the lower market access barriers and more vibrant Mexican economy that have resulted from NAFTA, Mexico ranks as one of our top export markets for a wide range of HVPs, including meats, fresh and processed horticultural products, pet foods and grocery products.

An interesting angle on the NAFTA success story concerns our market share in both Canada and Mexico. From the 1990s up until recently, our share of world agricultural trade had been slipping. However, thanks to the increased competitiveness of U.S. exports brought about by the reduction in market access barriers, our market shares in Canada and Mexico have grown, while our shares in most of our other major markets fell. Our share of Canada's agricultural imports has climbed to 65 percent, and our share of Mexico's imports is 75 percent. This means 75 cents of every dollar's worth of Mexican imports of agricultural products comes from the United States–up from 70 percent a decade ago.

AgExporter: What are the demand fundamentals likely to be?

Dwyer: They continue to look promising. Real economic growth in Canada is projected at roughly 3 to 3.5 percent a year over the next 10 years. The Mexican economy is expected to grow by 4 to 4.5 percent a year as the country continues to industrialize, benefiting from foreign investment inflows and trade liberalization. As Canadian and Mexican incomes grow, their food demand responds. This is particularly true in Mexico, where food demand is more sensitive to changes in income than in a more mature market like Canada.

In addition to these income gains, there are issues related to population and demographics. Mexico has a population of 105 million, and it is expanding by 1.5 to 2 percent a year. Mexico's middle class is expanding even faster, which is an important demand determinant with implications for the types of foods consumed–a greater emphasis on meats, fruits and processed foods. Canada has 32 million people, but its population is only growing by 0.5 percent a year. In Canada's case, most of the increases in food demand are coming from income growth and the accompanying increase in the demand for more healthful and upscale food products.

These demand factors, coupled with fewer market access barriers, mean consumers in both countries will want and will have increased access to the same U.S.-made food products as American consumers. These factors benefit most products but will particularly favor consumer-oriented HVPs, which include most of the fastest growing exports to Canada and Mexico over the past 10 years. And I see no reason why that trend would change as we move forward.


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AgExporter: What role have exchange rates played in U.S. agricultural trade?

Dwyer: That's one of the most telling signs of how well NAFTA has benefited U.S. exports since it was signed. Up until recently, the U.S. dollar had been very strong against the world's major currencies. This hurt the competitiveness of U.S. exports, vis-à-vis those of other suppliers, and was one of the main reasons why U.S. exports to non-NAFTA countries have not performed the way we would have liked.

Yet exports have exploded to Canada and Mexico, whose currencies, until recently, had also weakened against the dollar. Why the difference in trade performance? I believe it shows that the benefits of trade liberalization–the reduction of trade barriers facing U.S. goods–have outweighed the trade losses to American exporters that come from a strong U.S. currency. If the dollar weakens further against the Canadian dollar and Mexican peso, the value of the dollar will go from a factor restraining our export performance to our NAFTA partners to one that is more supportive. This, combined with reduced trade barriers and growing food demand, creates an environment that is conducive to export expansion.

While the growth of exports to Canada and Mexico over the next 10 years will be hard pressed to match the impressive growth of the past decade, we expect that it will continue to exceed that to the rest of the world.

AgExporter: How would you rate NAFTA's effectiveness?

Dwyer: Any trade agreement is going to have trade issues. As barriers come down and U.S. products move in greater volumes into our partners' markets, it increases pressure on their producers who may have a harder time keeping up with the competitiveness of U.S. producers. It is naïve to think those producers won't pressure their governments to intervene and protect them. We've seen it used against us time and again. It happens to various degrees in all countries, even here.

However, the test of any trade agreement is whether the needs of the many are considered when you are trying to protect the few. In the case of NAFTA, U.S. consumers have benefited immensely by the more open trading relationship we have with Canada and Mexico. They have access to more food and agricultural products at good prices, just as consumers in Canada and Mexico benefit from NAFTA through greater access to U.S. products. Consumer welfare in all three countries has benefited from the trade agreement.

Have U.S. producers and processors benefited from reduction in trade barriers? For the most part, yes, although clearly there are some who have found the increase in import competition more challenging than others. As discussed earlier, the evidence is pretty compelling that U.S. producers and processors have seen substantial export gains from NAFTA. The significant and broad-based increases in U.S. exports to Canada and Mexico since 1994 stand in stark contrast to the situation for U.S. exports to many of our other major markets, which experienced declines during this period.

But some ask whether NAFTA has resulted in a flood of imports. That's a fair question. After all, the data clearly show that imports from Canada and Mexico have grown sharply since 1994. However, I would argue much of that increase is not due to the trade liberalization effects of NAFTA. First, U.S. imports from other countries over the same period of time rose sharply as well–so increases from Canada and Mexico were not unique. Second, in an aggregate sense, U.S. import barriers were already low prior to NAFTA, so the incremental change after NAFTA was not sufficient to generate significant import surges.

A better explanation for the increased imports from Canada and Mexico, and other countries for that matter, involves macroeconomic conditions. The strong dollar, the strong U.S. economy, and weak economic conditions in much of the rest of the world combined to make the United States an attractive market for most foreign suppliers.

If NAFTA is any indication of what can happen from a free trade agreement, it should encourage U.S. producers to be more willing to pursue trade agreements with other trade partners. Instead of fearing the increased competition, focus on the increased opportunity that these agreements present. We have and will continue to carry out export programs such as market development, export credit guarantees and other trade expansion activities at USDA to help increase U.S. exports. However, for the United States, which enjoys significant cost-of-production advantages in a wide range of food and agricultural sectors, nothing can generate the kind of export gains that trade liberalization can.

AgExporter: In discussing demand fundamentals, you mentioned economic growth as an important factor. Can you explain further how this affects U.S. food exports?

Dwyer: The Mexican economy is growing by roughly 4 to 4.5 percent a year, generating more jobs and increased discretionary incomes. This allows consumers to improve the quantity, quality and diversity of their diets. With import barriers facing U.S. products substantially reduced from pre-NAFTA days, U.S. producers can more effectively compete with both Mexican firms and third-country suppliers for Mexico's growing consumer demand. That's what we have been successfully doing since 1994, and I see no reason that will not continue in the years ahead.

To some degree, the same holds true for Canada. Obviously, the income levels in Mexico and Canada are quite different. We don't expect to see growth in Canadian demand approximate that of Mexico. It's a more mature market for most products. However, some sectors are more mature than others. The fastest growing component of Canadian food demand is fruit, vegetable and processed grocery products, which helps explain why U.S. exports of these products to Canada have done so well over the past decade. The Canadian diet, like the U.S. diet, is putting increased emphasis on fruits and vegetables. We have a much broader diversity of horticultural production than Canada does, and we are the supplier of first choice for those products as well as for processed products.

AgExporter: Do Canada and Mexico buy a lot of inputs from us for their food processing industries?

Dwyer: Yes. One of our major agricultural exports is food ingredients. That's not just true of NAFTA, that's true on a global scale. It's truly been one of our export success stories over the last 10-15 years. The bottom line is the global processed food market is booming. Because we have such a productive food ingredient market and large production capability, we are the leading exporter, with the European Union a close second.

AgExporter: Is demand changing U.S. production and processing?

Dwyer: The demographic changes that are driving the U.S. food market also are driving the larger global market. With more people working and less time to prepare traditional meals, there's greater demand for ready-to-eat foods. There's


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also an increased emphasis on products' healthful characteristics.

These demographics are at play in Canada and to a lesser degree in Mexico. Although per capita incomes in Mexico tend to be much lower than our own, there are growing numbers of two-income households. This means two things. First, two-income households have less time to spend making traditional meals, so there's greater demand for convenience foods. Second, household incomes are much greater than per capita levels, so there's a greater ability to afford those convenience foods. These households tend to be in urban areas. Urban areas have more wealth and purchasing power than rural areas. That's where the majority of well-paying jobs are.

AgExporter: Those areas also have the infrastructure to support imports—cold storage, transportation and distribution.

Dwyer: That's right. Ownership of refrigerators is higher in urban areas because income levels are greater. Per capita ownership rates of microwave ovens, refrigerators, air conditioners, televisions—all those types of things—are growing over time. Those are good leading indicators. You can't sell perishable fresh and frozen foods unless households have refrigerators.

I think what's interesting is the growth of supermarkets. To a great degree it explains how U.S. processed food products are growing so rapidly in Mexico, in Central America and in Latin America. The growth of the supermarket as a retailing outlet versus the traditional mom-'n'-pop store is driving international trade in consumer-oriented HVPs.

There's been a fair amount of research done on the companies doing this retailing, and they are the same company names that are familiar in the United States, such as Wal-Mart and Ahold. The large food retailers are going global, and as barriers to trade come down, the economics are determining where the investment and trade take place.

Many times the standards of these food retailers are higher than the standards of the governments enforcing them. In other words, a supermarket retailer's standards for food quality and safety may well be higher than those of the country in which it operates. If the retailer is a large enough buyer, it can set the terms of its purchases from local and international suppliers. If local suppliers cannot meet the minimum threshold standards, that retailer will import to ensure the products meet certain corporate standards. This is happening all over the world.

AgExporter: Is this growth also happening with convenience stores, such as gas marts?

Dwyer: Convenience stores have a more prominent retailing role in many other countries than they do here. Typically we do most of our grocery shopping at large supermarkets, and do only impromptu, spontaneous purchases from convenience stores and gas marts. But in Asia and in Mexico, these kinds of markets account for a larger percentage of every food retail dollar.

AgExporter: Will there be a lot more international investments in other countries?

Dwyer: I think you can pretty much bank on that. Most of the growth for global supermarket chains will occur outside their home bases, mostly in a handful of rapidly growing developing countries. Certainly, this is true in Mexico, but China, South Korea and Indonesia, where food demand is rising rapidly, are also good candidates. Trade liberalization allows for greater competition, which makes this story more compelling for well-managed U.S. producers and processors. ■