NAFTA and its Impact on the United States

The North American Free Trade Agreement (NAFTA) is a great milestone in international trade for the United States, Mexico and Canada. It has liberalized trade among the three countries and had an overall positive impact on each country’s economies. NAFTA especially impacted the agricultural sectors of each country. Although there have been several trade disputes and controversial issues, the agricultural economies of each country benefited. Although many areas of each country has been greatly impacted by NAFTA, this paper emphasizes the economic impact the agreement has had on the agricultural sector of the United States. In addition, the United States’ relationship with Mexico will be discussed.

The first major international trade agreement in the world was the General Agreement on Tariffs and Trade (GATT). It was formed in 1947. Several countries, including the United States and Canada, were members of this agreement. Mexico joined GATT several years later. Many countries had economies that had collapsed due to the World War II, so GATT was designed to increase trade liberalization between countries. In the 1970’s and 1980’s, the United States, Mexico and Canada experienced economic problems. To improve their economies, the United States and Canada started a free trade agreement in
1989. In the next few years, United States agricultural exports to Mexico decreased as world competition for the Mexican market increased. To counteract this trend, NAFTA was implemented on January 1, 1994. The agreement proposed to eliminate restrictions on the flow of goods, services and investment in North America. This would, in turn, boost the economies of the three countries in the agreement.

Historically, the agricultural industry has been one of the most government-protected industries. The three member countries of NAFTA have used many barriers to trade in the past. Tariffs, quotas and subsidies are the most common barriers to trade. A tariff is a tax on imports. A tariff causes a decrease in imports in the imposing country because foreign countries are forced to pay a tax on their exports. This benefits the domestic producers because it causes an increase in the domestic supply, which causes an increase in the domestic price. A quota is another barrier to trade. A quota restricts the amount of imports. The effects of a quota are similar to the effects of a tariff. The third main trade barrier is a subsidy. Subsidies provide funds to certain domestic markets. This increases supply because the producers can afford to produce more. That causes an increase in market price and a decrease in quantity demanded. As a result, domestic producers benefit and consumers lose welfare.

Most of the agricultural trade policies arise from public concern about one of three major social problems. In the United States, dissatisfaction with the market distribution of income occurs because farm incomes were less than industrial incomes. Subsidies are usually used to prevent this problem. Another
problem is instability. Unregulated agricultural prices usually fluctuate more than industrial prices. There can also be demand and supply instability. The United States government has tried producer subsidies and taxes to stabilize the agricultural market. Theses measures might improve welfare and national income. Although more important in less developed countries, food security in the U.S. is another reason to protect the markets. Food security refers to a country’s ability to prevent food shortages. In the United States, food security is only an occasional price or supply instability problem, and relatively smaller barriers to trade are sometimes necessary. Although barriers to trade may help certain domestic markets in the short-run, they have a negative long-run impact on the world and domestic markets because they reduce competition.

The main objective of NAFTA was to eliminate barriers to trade and investment between the United States, Mexico and Canada. Tariffs, quotas and subsidies are the most common barriers to trade. Approximately half of the tariffs on trade between Mexico and the United States were eliminated, and the remaining tariffs and restrictions on service and investment will be phased out over a 14-year period, ending January 1, 2008. In 1993, United States goods faced an average tariff barrier at the Mexican border of about 10 percent, five times the 2.07 percent rate that the U.S. imposed on Mexican goods. With NAFTA, Mexico’s average tariff has fallen to under 2 percent.

Other objectives were to promote fair competition, protect intellectual property rights and increase investment opportunities. NAFTA provides full protection of intellectual property rights (patents, copyrights, and trademarks) and
also includes provisions covering trade rules and dispute settlement. In addition, the treaty establishes trilateral commissions to administer them. In response to increasing environmental awareness, NAFTA became the first international trade agreement in United States history to include environmental policies. Foreign investment was another key issue that was addressed. NAFTA was designed to increase foreign investment opportunities. The treaty’s rules concerning foreign direct investment have improved rights of foreign investors by aiding investors in retaining profits and returns from their initial investments. As a result, U.S. direct investment in the Mexican food processing industry has more than doubled since 1994. Most of these investments are concentrated in processed products such as pasta, candy, and canned and frozen meats.

NAFTA has caused both positive and negative impacts to the United States. However, the positive impact seems to outweigh the negative impact. Although NAFTA has been largely responsible for most of the economic changes, there are also several other factors to consider. These include adverse weather conditions, exchange rate movements, macroeconomic performance, evolving consumer preferences, population growth and technological change.

The main effect has been a huge increase in United States agricultural exports to Mexico. U.S. agricultural exports to Mexico have been continuously growing since NAFTA started, despite a decrease in world and aggregate United States exports. They account for more than seven billion dollars, which is approximately 6% of the total U.S. exports to Mexico. Another staggering statistic is that United States agricultural exports to Mexico have doubled since
1994 and U.S. supplies more than 75% of Mexican agricultural products. Graphs #1 and #2 below show this growth. Graph #2 shows a negative export growth rate of United States exports to Mexico in 1995. This was caused by the peso devaluation during Mexico’s worst economic crisis in history. However, NAFTA helped keep Mexican markets open to United States agriculture products, and this helped Mexico’s economy to recover. Agricultural exports to Mexico have increased every year since.

The United States exports to Mexico that grew the most in terms of percentage volume change were rice, cotton, apples, pears, cattle and dairy products. Corn grew the most in terms of total volume. High fructose corn syrup also grew substantially. Sorghum was the only export that decreased in volume. On the other hand, sugar and peanuts were the fastest growing United States. Tomato and cantaloupe imports from Mexico also grew. Some export and import commodities have felt little impact since 1994. The chart below shows the effect NAFTA has had on each commodity.

This boom in agricultural trade is due in part to lower relative transaction costs because of Mexico’s proximity to the United States. It is also due to the utilization of each country’s comparative advantages. For example, the United States can produce animals and animal products, grains and oilseeds more efficiently than Mexico. Hence, the United States has a comparative advantage in these products. On the other hand, Mexico can produce vegetables, fruits and fresh flowers more efficiently and have the comparative advantage in these products. Each country will benefit the most economically if they only produce
and trade products in which they have comparative advantage. Another important reason for high growth is the protection of each country’s import-sensitive crops. NAFTA allowed Mexico and the United States to protect their import-sensitive crops with longer transition periods to eliminate barriers to trade. Import-sensitive product markets would fluctuate too much if there were no protection. For the United States and Mexico, dairy products, cotton, peanuts and sugar are import-sensitive.

Another positive impact of NAFTA has been an improved transportation system in both countries. Better transportation became necessary because of the high growth rate in agricultural products. Mexico has benefited most in this area. NAFTA became the first trade agreement in the history of the world to include environmental policies. The elevated incomes in each country as a result of NAFTA have helped fund environmental causes. These policies help counteract the additional pollution caused by NAFTA. The last positive impact has been a slight increase in United States jobs in the agricultural industry. This was due to the increased supply of agricultural products.

NAFTA has also had a negative impact on the United States. There have been several trade disputes since the inception of the treaty. For the most part, Mexico has been the originators of the disputes. Mexico has threatened and imposed import restrictions on several crops. One of the major disputes has been over high fructose corn syrup (HFCS). It has been heavily exported from the United States to Mexico in the past few years. In 2001, Mexico imposed a tariff on HFCS to limit its importation from the United States. The tariff was
against NAFTA policy. Mexican soft drink producers then switched from HCFS to domestic sugar because of the lower relative price of sugar. This caused the sugar production in Mexico to rise and the corn production in the United States to fall. Anti-dumping duties have also been used by Mexico. These prohibit the United States to sell their exports to Mexico for less than the cost of production, which in turn, increases market share. Trade disputes between the United States and Mexico are much more important since NAFTA began because each country now relies on the other one so much for agricultural goods.

The U.S. has suffered a decrease in labor supply as a result of NAFTA. There has been a substantial decline in employment in the United States textile and apparel sectors. The building of maquiladoras was largely responsible for this decline. Maquiladoras are foreign owned factories in Mexico, most of which are United States owned. While the United States has shifted many jobs to Mexico because of these factories, there has been debate about the exploitation of the low-wage workers. Despite this employment shift, the agricultural industry in the United States has experienced a slight increase in employment. This boost in United States labor supply in the agricultural industry helps to balance out the decrease in the textile industry.

There have been differing opinions on environmental and food quality issues. Over the last ten years, NAFTA has caused environmental problems because of the rapid agricultural changes, primarily in Mexico. This has affected Mexico more because their environmental protection infrastructure is not as developed as that of the United States. To prevent the foreseen pollution and
other environmental hazards, environmental policies were addressed in the original treaty in 1994. Food quality has been another negative impact. Mexico and the United States have very different policies regarding food quality, so goods that meet one country’s policies may not meet the others. NAFTA laws have been made to coordinate food quality policies to improve upon the quality of food. Efforts to inspect and approve at the regional level, and in some cases at the level of individual producers, have opened up new markets between countries.

NAFTA has enabled United States agricultural producers and consumers to more effectively use their comparative advantages and to respond more efficiently to changing economic conditions. Although the free trade agreement has caused some negative impacts, the positive impacts seem to outweigh them. This is especially true for the agricultural industry in the United States, in which agricultural growth has been phenomenal. The treaty has also greatly enhanced United States foreign relations with Mexico. NAFTA has helped to unite North America, economically and socially.
Bibliography


