Gauging NAFTA's Success and Confronting Future Challenges


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NAFTA (the North American Free Trade Agreement) and its predecessor, the CFTA (U.S.-Canada Free Trade Agreement), were designed to make the North American market more efficient and thereby enhance the economic well-being of the United States, Canada and Mexico.

The principal means to achieve this objective was to foster integration of the three countries' markets by eliminating trade and investment barriers that interfered with fundamental economic forces and inhibited the international competitiveness of each NAFTA member.

Impetus for Market Integration

In a more integrated continental agricultural market, farmers are better able to specialize in production activities in which they are comparatively proficient; consumers enjoy lower prices for food; and society reaps rewards from increasing returns due to technological innovations and economies of scale. The benefits of integrated markets explain the creation of the Common Market and its expansion into today's EU (European Union), participation by many countries in regional trade agreements and the genesis of the General Agreement on Tariffs and Trade and its successor, the World Trade Organization.

Policy shifts and recent changes in the trade and investment record suggest that CFTA and NAFTA have contributed to the increased integration of North American agriculture. In addition to lowering tariffs or eliminating them altogether, the agreements converted many non-tariff barriers to tariff equivalents.

CFTA and NAFTA also accorded national treatment to foreign direct investment that triggered an avalanche of foreign capital into and out of the United States, Canada and Mexico. As a result of such investment, many large food corporations (i.e., Grupo Industrial Bimbo, Kraft, McCain Foods and PepsiCo) organized themselves as North American rather than national companies. Today, these conglomerates outsource many operations to take advantage of differences in production costs across member countries and to enhance their ability to respond to the demands of the enlarged continental market.

Explosive growth in the real value of agricultural trade within the NAFTA region (intra-NAFTA trade) also points to greater market integration in agriculture due to the free trade agreements.

Between 1987-88 and 2000-01, agricultural trade among the United States, Canada and Mexico increased 155 percent, surging from $11.2 billion to $28.6 billion in real (1989-91) terms. Data used in this analysis are derived from the Comtrade system of the United Nations. Of particular significance is that intra-regional export market shares grew faster than exports supplied by the United States, Canada and Mexico to countries outside NAFTA.

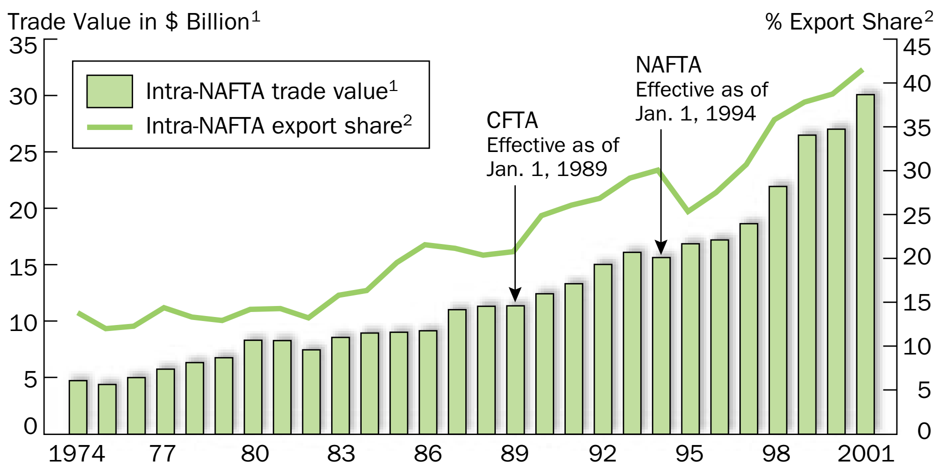
Clearly, North America has become an increasingly important market for U.S. agricultural exporters. Canada is now the largest importer of U.S. agricultural goods, displacing Japan in 2002. Mexico surpassed the EU as an export market for U.S. agriculture two years earlier.

Similarly, the United States is a very important market for agricultural exporters in Canada and Mexico. The share of Canadian exports absorbed by the United States climbed from 39 to 67 percent between 1991 and 2002. The share of Mexican agricultural exports destined for the United States is even higher, averaging 83 percent during the past decade.

Challenges and Paths to Progress

Despite the progress made, more could be done to deepen market integration within North America, as the continental market remains more segmented than the individual national economies of the United States, Canada and Mexico.

Trade Shares Show That Intra-NAFTA Agricultural Trade Has Grown Faster Than NAFTA Partners' Trade With the Rest of the World



[1] Total value of U.S., Canadian and Mexican agricultural exports to (imports from) each other.
[2] Percent share of trade among the NAFTA partners compared with their exports to countries in the rest of the world. For example, in 2001, about 41.6% of the combined U.S., Canadian and Mexican trade took place among themselves, and about 58.4% of their trade was with countries outside NAFTA.
Source: ERS International Bilateral Agricultural Trade data derived from UN Comtrade deflated by FAOSTAT trade indices.

Prior to the implementation of CFTA and NAFTA, within-country trade was about 20 times larger than between-country trade in North America, after controlling for the influence of distance and market size. By 2000-01, within-country trade was about 12 times greater than between-country trade.

The discrepancy still remaining between internal and cross-border trade suggests that the North American market would become more efficient and better integrated if all noneconomic barriers inhibiting cross-border trade and investment were removed.

The major dilemma confronting the emergence of a truly unified North American economy is that, while product and input markets are becoming more integrated across international borders, the institutions to support this integration remain largely national. Harmonized product, health, safety and environmental standards have yet to be widely established, and contentious issues remain in such areas as dairy, beef, sugar, wheat, rice, corn, livestock, lumber, transportation and labor migration. Most agricultural disputes among the NAFTA countries stem from differences in national laws and regulations, divergent domestic farm programs and incompatible macroeconomic policies.

The policy agenda that must be addressed if further market integration is to take place within North American agriculture is likely to be more complex than the agenda that was agreed upon during the CFTA and NAFTA negotiations. A consensus about goals, guiding principles, and rules and procedures for handling disputes is essential.

All three NAFTA countries divide authority constitutionally between national and regional governments. The federal structure of member country governments creates challenges in forging a unity of purpose and devising policies that effectively and fairly address issues at the root of divisions.

One possible way to advance North American market integration is to enhance the influence of existing institutions: the NAFTA dispute resolution process, the various NAFTA committees (such as the Committee on Sanitary and Phytosanitary Measures) and informal working groups (such as those focused on migration, animal health and rules of origin). Another avenue is to create cross-border federal task forces charged with reaching agreement about how to resolve contentious problems in ways that incorporate common interests. ■

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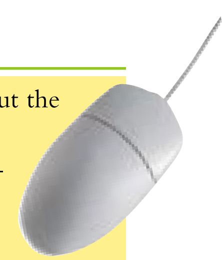

For further information about the integration of the U.S., Canadian and Mexican agricultural economies, see the report entitled "North American Agricultural Market Integration and Its Impact on the Food and Fiber System" on the ERS home page: **www.ers.usda.gov/publications/aib784/**