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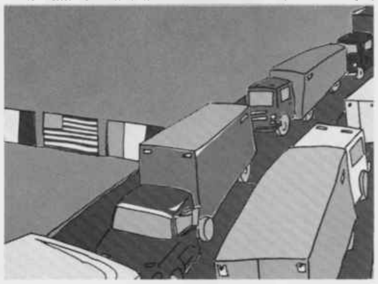


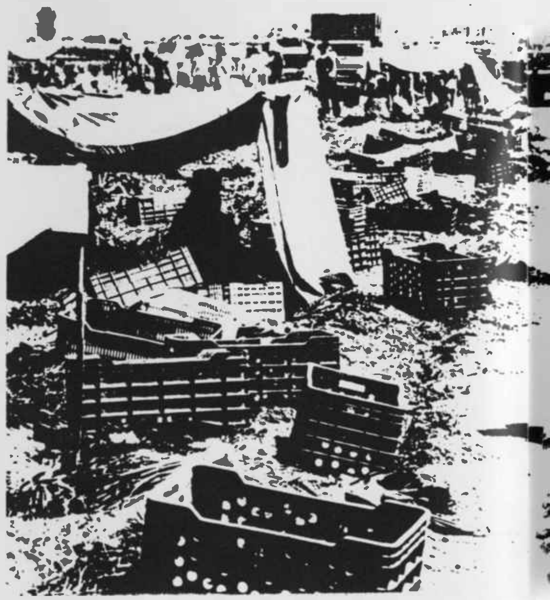
The Impact of Free Trade

Does Arizona agriculture face increased competition or opportunity?

By Maggy Zanger

Allan Fertig

Harry Ayer



Increased development in Mexico should generally increase the demand for U.S.-produced foods.

Daily, trucks line up at the border crossings between the U.S. and Mexico. Laden with colorful boxes of fresh tomatoes, cucumbers, lettuce, onions and broccoli, trucks arrive from the fields of Mexico destined for U.S. dinner tables. Headed in the other direction, trucks full of U.S.-produced corn, milk and meat head south for Mexican markets.

This seemingly free-flow of agricultural products between the two countries is actually impeded by a variety of trade barriers. But they may be about to go the way of trade restrictions between the U.S. and Canada, which began to be dismantled in 1989 with a Free Trade Agreement (FTA).

In June last year, U.S. President George Bush and Mexico President Carlos Salinas de Gortari proposed expanding free-trade to include the U.S. and Mexico, which would create an open market from the Yukon to the Yucatan. The proposed North American Free Trade Agreement would eventually remove current duties, licensing requirements and quotas slowing trade between the U.S. and Mexico.

What this probably means for Arizona agriculture is increased competition, but also some increased opportunities, says Harry Ayer, University of Arizona Cooperative Extension agricultural economist.

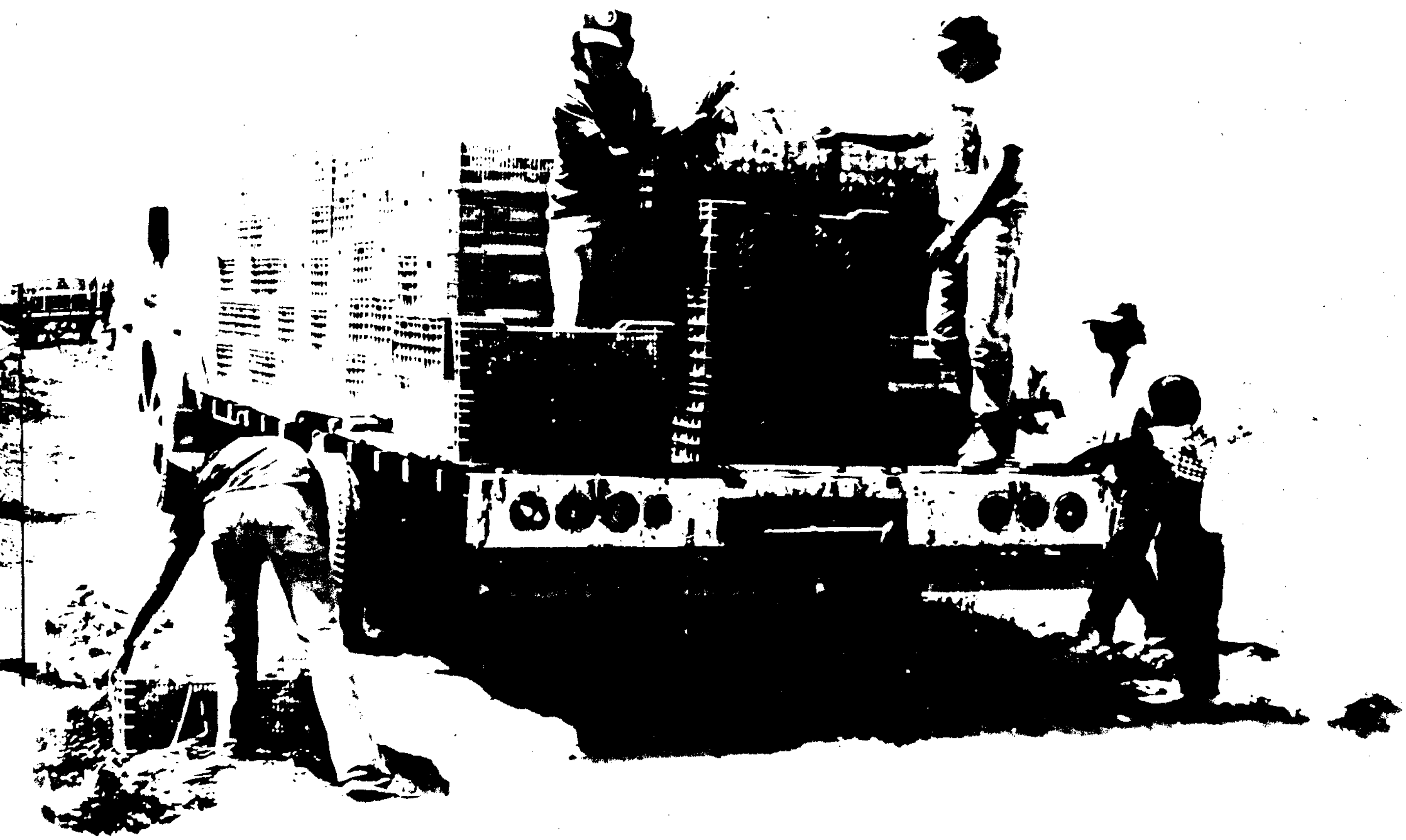
"We don't have a detailed analysis yet, but we do have a pretty good idea of which agricultural sectors will face increased competition and which sectors will have increased marketing opportunities," he says. "How much more competition or how much greater the market is hard to say."

Alberto Maldonado, president of the West Mexico Vegetable Distributors Association, agrees with Ayer's assessment. He also believes some agricultural sectors may be harmed and some may benefit.

"This will help the economies of both countries," he says. "We'll all have to adjust to the changes without, at this time, being able to say exactly which changes."

Arizona fruit and vegetable producers are likely to encounter increasing competition from Mexican producers, Ayer says. But apple producers may benefit from expanded market opportunities. Cotton, one of Arizona's largest agricultural interests, will probably not be greatly affected by the impending FTA between the U.S. and Mexico. The impact on dairy and cattle sectors is more difficult to predict.

This summer Congress approved fast-track authority allowing President Bush to negotiate an agreement with Mexico that Congress can only accept or reject, but not amend. While formal provisions are not yet on the table, Ayer says he expects the U.S.-Mexico FTA will be similar to the agreement the U.S. and Canada negotiated, eliminat-



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ing, or greatly reducing, all trade barriers over a period of years. An agreement should be hammered out between the U.S. and Mexico by 1992 and implemented by 1993, he says.

The impact of the U.S.-Mexico FTA will depend largely on what trade restrictions are now in place.

"Over the last five years, Mexico has reduced its barriers to trade significantly," Ayer says. "So some need for a FTA is already taken care of, but significant barriers still exist, particularly in agriculture."

Mexico and the U.S. are important trading partners. About nine percent of each country's total exports to the other is in agricultural products. Several barriers to the free trade of agricultural products exist: import tariffs or duties, licensing requirements, phytosanitary rules, and marketing orders.

Currently about 40 percent of agricultural products enter the United States duty-free, but another 60 percent are subject to an average seven percent import tariff. U.S. agricultural products entering Mexico are subject to an average 11 percent tariff. An FTA should eventually eliminate all tariffs. It may be phased in over a number of years to soften the blow to some adversely effected sectors and allow them time to adjust, Ayer says.

The wage differential between the U.S. and Mexico is extreme.

Both countries also limit imports through phytosanitary requirements designed to protect animals and plants from disease. While serving as a necessary health precaution, Ayer points out that critics say some requirements are based less on scientific evidence than on an effort to restrict trade. An FTA should remove phytosanitary rules not based on solid health needs.

In addition, Mexico requires import licenses for some agricultural products, which, in effect, imposes quotas on how much can be imported. An FTA will probably eliminate these license requirements, Ayer says.

The barriers are not only imposed by Mexico. The United States limits imports through marketing orders which stipulate size, color, maturity or even box size of a product. These requirements were put in place largely to ensure an orderly marketing of high quality products, Ayer says. But observers feel that, like phytosanitary requirements, some marketing orders have been used to protect producers. Again, marketing orders not based on real need will probably be phased out.

Eliminating these various barriers will effect sectors of Arizona agriculture differently, Ayer says. For some, the FTA will increase competition. Other farmers will find new markets open to them in Mexico. The impact depends upon not only current barriers in place, but also on the amount of labor needed to produce a specific commodity, and on Mexico's ability to grow, process and transport a crop.

Labor cost plays a significant role because some types of agriculture are labor-intensive, Ayer says. The wage differential between the U.S. and Mexico is extreme. U.S. agricultural workers earn from $5 to $9 an hour, while Mexican workers earn from 60 cents to $3.50 an hour. Labor-intensive agriculture will undoubtedly

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face increased competition from Mexican producers who will be able to more cheaply raise, harvest and package their product. However, the FTA may act as a leveler for the wage differences.

"When you open up trade, prices tend to come closer together," Ayer says. "So over time, I expect Mexican wages will increase. Whether U.S. wage rates will diminish is not so clear."

Wage differences create a problem for Arizona's fruit and vegetable producers. Often the labor component can be 70 percent of the operating cost of producing vegetables and fruit. Arizona produces broccoli, cauliflower, cucumbers, asparagus, onions, lettuce, squash, grapefruit and oranges. All are labor-intensive, eating up 40 to 70 percent of the operating costs of production.

Presently, U.S. import tariffs range from 5 to 22 percent on these products, somewhat protecting Arizona growers. Phytosanitary requirements and marketing orders also exist for many fruits and vegetables. That will change with the FTA.

Because Mexico is already producing many of these products, infrastructure such as irrigation facilities and grower associations are already in place. In recent years, Mexico has also moved unilaterally to make foreign investment more attractive, so new agriculture processing and freezing plants are increasing. All these factors indicate removing barriers will allow Mexico to produce and export more fruits and vegetables to the U.S.

Arizona's apple production is an exception to the bad news.

"I expect that we will experience increased competition from Mexico as a result of the FTA in the vegetable and fruit sectors," Ayer says. "Also, the FTA should encourage more investment, so food processing plants in Mexico will no doubt increase."

Arizona's apple production is an exception to the bad news. Mexico's climate is not conducive to apple growing. Additionally, Mexico currently imposes a 15 to 20 percent tariff on apple imports and strict licensing and phytosanitary controls. Eliminating these barriers should expand markets for apple growers in Cochise and Graham counties.

Arizona's cotton growers probably will not be heavily affected by an FTA, Ayer says. Both the U.S. and Mexico currently produce and export cotton on the world market, so he doesn't anticipate that markets will increase in either country. And since cotton is not particularly labor-intensive, it is unlikely cotton production will shift to Mexico.

The impact on the cattle industry is a little more complicated.

The impact on the cattle industry is a little more complicated. It's not clear yet which way the FTA will make things go. In general, Arizona ranchers have encountered increased competition from Mexico due to low wages there, and that will continue with or without the FTA.

Mexico currently provides nearly all of U.S. imports of feeder cattle. But imported feeders are only three percent of U.S. slaughter cattle. Trade is currently restricted by a 1.5 percent U.S. tariff and Mexico's five percent export tariff on feeder cattle. However, Mexico is already moving unilaterally to remove the export tax, so the FTA may have little impact.

U.S. ranchers have always had the benefit of abundant feed grain. Mexico does not produce much grain and has a nearly 10 percent tariff on feed grain imports in addition to quotas and licensing restrictions. The FTA may eliminate these barriers, allowing Mexican cattle producers to import grain more cheaply. Transportation will play a crucial role. Generally, shipping grain costs more than shipping cattle.

If grain can be economically transported to the interior of Mexico (perhaps by ship)—and the FTA encourages the investment in packing plants in Mexico—Arizona feedlots may face increasing competition. On the other hand, if transportation costs remain high, slaughter plants may locate nearer the border, and then Arizona feedlots will benefit.

"It's hard to tell where it will all shake out because of the transportation issue, " Ayer says.

Grain availability also plays a role in the future of the dairy industry in Arizona. One of the largest U.S. exports to Mexico is non-fat dry milk. Many trade barriers to that export now exist, including a 20 percent Mexican tariff on milk products and occasional quantity restrictions on non-fat dry milk.

Milk production in the U.S. is not particularly labor intensive—typically labor represents 8 to 10 percent of operating costs. Removing trade restrictions may therefore increase Mexican markets for milk products.

However, if grain exports to Mexico increase, dairy production in Mexico may well increase, adding to competition with U.S. exporters. Unlike labor, feed costs constitute a large portion of milk production costs, so cheaper grain will benefit Mexican dairy producers.

Additionally, Mexican milk producers are using BST, the milk-increasing hormone not yet approved for use here. BST, coupled with increased grain availability, may give Mexican dairy producers a competitive edge in the domestic market, Ayer says. "So how dairy will shake out is unclear."

Aside from the impact the FTA may have on specific sectors of Arizona agriculture, Ayer points out that increased development in Mexico should generally increase the demand for U.S.-produced foods. When agricultural sectors of less-developed countries expand, farmers have more money to spend and tend to demand more agricultural products. Thus, the market for foods that the U.S. farmers produce efficiently increases, and exports rise.

Some sectors may be harmed and some may benefit.

"If you check the data for a number of years to see where demand for our agricultural has increased, you'll notice that it's in those less developed countries whose agricultural sectors are developing most rapidly," Ayer says. "So the more that Mexico's agriculture gets moving, in general, our agricultural sectors will benefit. Though particular sectors will have a harder time. That's the key difficulty with the FTA."

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Julio Atondo (left) and Steve Rainey check the green onion crop daily.

The Other Side of the Coin

Importing Vegetables from Mexico

By Lorraine B. Kingdon

Quality is Steve Rainey's No. 1 concern. The Yuma-based entrepreneur who owns STR Sales, Inc., ships vegetables grown near San Luis in Mexico to all parts of the United States and into Canada.

"We're a small company," Rainey says. "We've built a reputation for quality and service that sets us apart. I take a great deal of pride in the fact that I'm in minute-to-minute contact with Angel and Julio Atondo, who grow the produce I sell.

"They know we both get a higher price because of higher quality, so we both work very hard to maintain our reputation." Rainey works on commission, a percentage that depends on the market price.

Pesticides—and pesticide contamination—are no more a problem than with any U.S. vegetable grower. People who worry about "the circle of poison" coming from Mexican food imports are mistaken. Importers face stringent regulations bringing produce into this country and undergo constant, random testing by the Food and Drug Administration.

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