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WILL CAFTA BE A BOON TO FARMERS AND THE FOOD INDUSTRY? NAFTA's Failed Promises Are Doomed to Be Repeated

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Promoters of the proposed Dominican Republic/Central American Free Trade Agreement (CAFTA) have asserted that it will provide significant benefits to the U.S. economy, especially to the agricultural sector. Similar promises were made in the debate on the North American Free Trade Agreement in 1992 and 1993. However, since that time NAFTA has failed to live up to these promises, and similar promises made for CAFTA are even less likely to be fulfilled.

Some of the key promises made during the NAFTA debate in Congress that have since been broken are summarized in **Table 1**. It is clear from the table that NAFTA has failed to provide overall trade benefits or to fulfill many of the individual promises made to commodity producers. The exaggerated claims of expected benefits that are now being made for CAFTA are equally as likely to go unmet.

NAFTA and CAFTA proponents have made broad promises about the potential for export growth and about the numbers of jobs that will be generated as a result. They imply that exports will grow faster than imports and that there will be trade surpluses for generations to come. While it is true that growing exports are good for the economy, growing imports actually displace domestic production that would support employment in the United States. When agricultural imports rise faster than exports, as was often the case under NAFTA, the result is a net drain on farm output and employment.

Given that the United States had already made a free trade agreement with Canada in 1989, NAFTA was really about expanding trade with Mexico. But there has been absolutely no change in the U.S. agricultural or food products trade balances with Mexico since NAFTA took effect. This is remarkable since, as the Office of the United States Trade Representative (USTR) noted: "Mexican tariffs are 2.5 times as high as U.S. tariffs,

TABLE 1
NAFTA and CAFTA: Promises versus reality

PROMISES	RESULTS
“The most significant trade expansion from NAFTA will be with Mexico” (USDA 1993b,3)	There has been no net change in the trade balance with Mexico in either agricultural or food products (see Figure 1).
“U.S. Agriculture and American Farmers are big winners under the NAFTA” (USTR 1993,6, emphasis in the original)	The U.S. trade deficit in food and agriculture with Canada increased by \$4.3 billion between 1993 and 2004. Meanwhile, the trade balance with Mexico did not improve.
“Greater trade” will “add as many as 54,000 more jobs” in “food processing” and related industries USDA” (1993a, 2)	The U.S. \$1 billion surplus in food products trade with Mexico and Canada turned into a \$2 billion deficit, resulting in the net loss of 16,000 jobs in food processing alone (Scott and Ratner forthcoming).
“Annual U.S. farm cash receipts are expect to increase by about 3% compared with projected receipts without NAFTA” (USDA 1993b, 4)	Real cash receipts in agriculture declined an average of 3.1% between 1991-93 and 2001-03 (USDA 2005a).
	In addition, net farm income declined from \$52.7 billion (real 2000 dollars) to \$47.0 billion, a decline of 10.8%.
“NAFTA is also expected to reduce farm program payments” (USDA 1993b, 4)	Real direct government payments increased 29%, on average, between 1991-93 and 2001-03 (USDA 2005a).
	Net farm income less direct government payments declined 22.3%.
The USDA promised that there would be many benefits for farmers growing corn, beef, swine and other commodities” (USDA 1993b, 8,18,25,26)	NAFTA failed to deliver on promised benefits for each of these commodities.
The Dominican Republic and CAFTA countries “make up the second largest market in Latin American, behind only Mexico” (Office of the USTR 2005a). “Per capita incomes range from \$2,000 to over \$8,500 (PPI data), providing substantial upside potential for expanded growth of income and food demand” (Office of the USTR 2005b).	Mexico's GDP was \$626 billion in 2003, seven times larger than the combined output of the DR and CAFTA countries of \$84 billion (World Bank 2004). Per capita GDP estimates measured with PPP indexes are almost meaningless in a region where extreme poverty is widespread, and where many of the economies are essentially dollarized.

and Mexico also relies on non-tariff barriers to restrict access to their markets. NAFTA will level the playing field” (USTR 1993, 10). The fact that so much leveling has taken place, and yet the results of the game are unchanged, suggests that NAFTA has been a failure as a trade strategy.

NAFTA has also failed to deliver on its promised benefits to the poorest citizens of the hemisphere, many of them living in Mexico. Real wages of Mexican manufacturing workers have fallen despite a decade of strong GDP growth (Salas 2001). There have been substantial increases in informal-sector work such as street vending and unpaid family work in stores and restaurants. One major study concluded that “NAFTA has not helped the Mexican economy keep pace with the growing demand for jobs....The agricultural sector, where almost a fifth of Mexicans still work, has lost 1.3 million jobs” (Audley et al. 2003, 5-6).

These experiences raise serious questions about the likely economic impact of CAFTA on the agricultural sectors, both in the United States and, perhaps more importantly, in our neighbors in the Dominican Republic, Costa Rica, Guatemala, Honduras, Nicaragua, and El Salvador.

Déjà vu all over again?

The U.S. Trade Representative (USTR) has a history of both making inflated claims about the benefits of proposed agreements and exaggerating claims about the importance and economic potential of the trading partners themselves. The USTR has claimed that “U.S. agricultural exports to the [CAFTA] region totaled \$1.6 billion in 2003” (USTR 2005b). In fact, according to official Department of Commerce statistics, the United States only exported \$834 million in agricultural products and livestock and livestock products to the region in 2003 (U.S. International Trade Commission 2005).¹ The USTR’s assertion of high export totals in agriculture can only be reconciled by including processed food products, beverages, and tobacco products (total exports of these and all agricultural products was \$1.564 billion in 2003).

The USTR has claimed that “with population and consumption growth for many farm products stagnant in the United States, access to markets such as those in Central American is critical for the growth of U.S. agriculture.” It further projected CAFTA “could expand U.S. farm exports by \$1.5 billion a year” (USTR 2005b). But the USTR has been silent on the growth of imports, and the growth of U.S. agriculture depends on what happens to both exports and imports.

Central to this argument is the claim that the countries in the region “make up the second largest market in Latin America, behind only Mexico” (USTR 2005a). The USTR also claims that “the population of [the CAFTA countries] ... is over 40 million. Per capita incomes range from \$2,000 to over \$8,500 ... providing substantial upside potential for expanded growth of income and food demand” (USTR 2005b).² These statements echo claims made about NAFTA and Mexico in the early 1990s, as noted below, although claims of CAFTA’s benefits are even less grounded in reality. The United States had an \$812 billion deficit in agricultural products with the CAFTA countries in 2004, nearly three times larger than the \$289 million agricultural trade deficit with Mexico in that year. Clearly, the CAFTA countries are a poor market for U.S. farm products.

Mexico had a population of 103 million in 2003, more than twice as large as the CAFTA countries (World Bank 2004). But this measure is much less important for trade purposes than gross domestic product (GDP). Mexico’s GDP was \$626 billion in 2003, seven times larger than the \$84 billion combined output of the Dominican Republic and the other CAFTA countries. The USTR’s estimates of per capita GDP calculated using purchasing-power parity (PPP) price indices, are almost meaningless in a region where extreme poverty is widespread and where prices in many of the economies are often expressed in dollars.³

The USDA has provided pro-CAFTA “State Fact Sheets” for 44 individual states, describing the expected benefits to each major farming sector (USDA FASOnline 2005a). Not to be ignored, the six remaining states are covered in a blanket “New England Fact Sheet.” Fact Sheets are also available for 19 commodities, including a report titled “What’s at Stake for Dog and Cat Food.”

“California Farmers Will Benefit” is a typical example of the FAS CAFTA Fact Sheets. Its central thesis is that “despite \$1.6 billion in U.S. farm exports in 2003, CAFTA-DR countries continue to impose high

tariffs and other barriers on most agricultural products, including California's key exports. A primary U.S. objective is to change the 'one-way street' ... into a two-way street." The report predicts that California producers of dairy, fruits, tree nuts, vegetables, rice, beef, and wine will benefit. Such claims echo USDA forecasts from the NAFTA debate—forecasts that have failed to materialize.

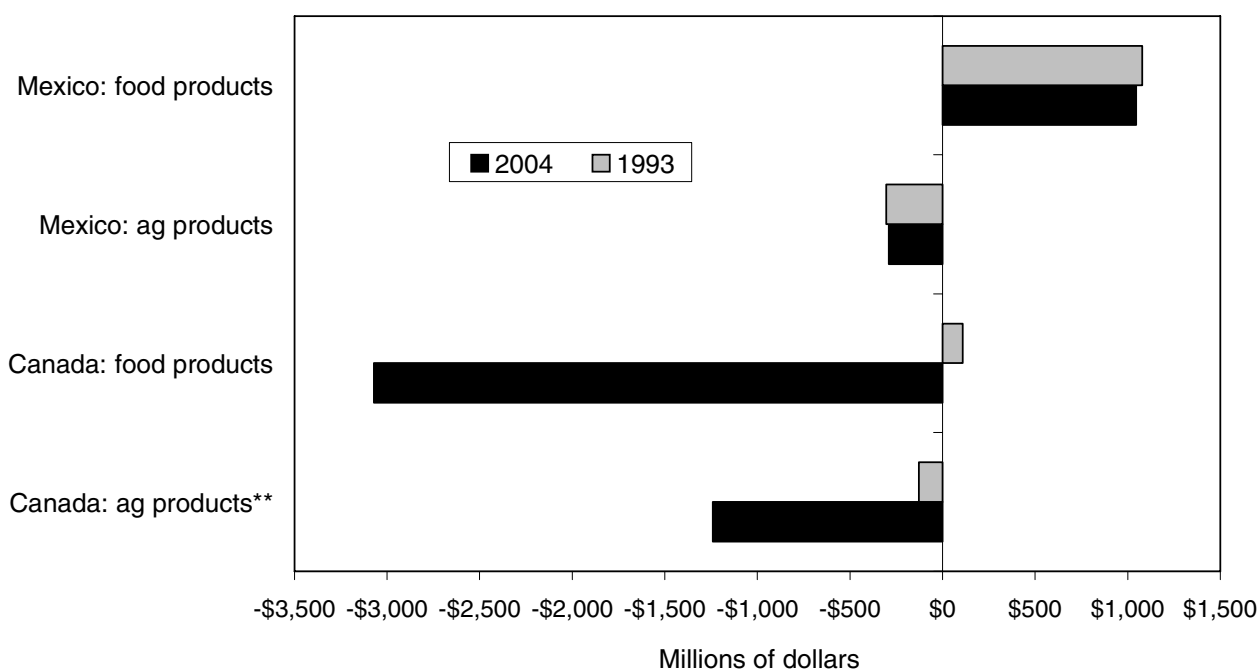
NAFTA's effects on U.S. agriculture and food trade

In 1993, the USDA argued that although Mexico's agricultural exports to the United States were expanding, "U.S. agricultural exports to Mexico have grown at a faster rate so that the United States achieved a positive agricultural trade balance with Mexico in 1991 and 1992." It also asserted that "Mexico's comparative advantages suggest that it will continue to be a net importer of food, feed, and fiber, [which] assures continued growth in export opportunities." It based this assertion on the observation that "Mexico's population (about 92 million) which is growing at more than 2% a year and becoming increasingly urbanized, represents a significant market for U.S. agricultural products" (USDA 1993b, 3).

Taken together, such predictions suggested that under NAFTA, growing exports to Mexico would support growth in the food and farm industries. This is a partial and incomplete view. The growth of exports can support expanded production and jobs, but the growth of imports displaces domestic production and employment. Hence, the best measure of the overall effects of trade on the economy must take into account the effects of imports as well as exports.⁴ In order to stimulate growth, the trade balance (exports minus imports) must improve over time.

Figure 1 compares U.S. trade balances in agricultural and food products with Canada and Mexico in 1993 (the year before NAFTA took effect) and in 2004. Mexico stands out because there is simply no significant change in the trade balance in either agricultural or food products. Yet the USDA claimed that the "most significant trade expansion from NAFTA will be with Mexico." Although two-way trade with Mexico has expanded, it has not provided a net stimulus of any kind to either sector. In fact, NAFTA has significantly restructured U.S. agricultural trade with Mexico since 1993, expanding exports of corn, soybeans, and other cash grains, while reducing demand just as much in other sectors of the farm economy, through growing imports or reduced exports. Even though export volumes of some cash grains have increased, the prices farmers received for commodities such as corn and soybeans have fallen by 8 and 10 cents per bushel, respectively (USDA Economic Research Service 2005b and 2005c). Farmers are working harder for less as a result of NAFTA and other changes in U.S. agricultural policies, especially the 1996 "Freedom to Farm" act, which eliminated acreage restrictions and stimulated overproduction of many crops (Scott 1999 and Scott and Hersh 2001).

The second noticeable trend in Figure 1 is the sharp increase in U.S. trade deficits with Canada under NAFTA in both agricultural and food products. The U.S. farm deficit with Canada increased from \$100 million in 1993 to \$1.1 billion in 2004 (U.S. International Trade Commission 2005).⁵ The small U.S. food products surplus with Canada in 1993 disappeared, transforming into a \$3.1 billion deficit by 2004. Thus, the United States experienced a net decline in its trade balance with Canada in food and agricultural products of \$4.3 billion. In many cases, predicted U.S. benefits from growing trade with Mexico were more than offset by declining trade balances with Canada in exactly the same sectors. For example, the USDA claimed that

FIGURE 1**U.S. trade balance with Canada and Mexico in agriculture and food products, 1993 and 2004***

* Trade balance represents domestic exports minus consumption imports.

** Canadian ag products include cattle net exports for 2002.

Source: USITC and author's analysis.

“grains and meats are expected to account for the majority of the expanded value of U.S. agricultural trade,” noting that “Mexico is one of the fastest growing export markets for U.S. meat.” And indeed, the U.S. surplus in meat products with Mexico expanded from \$700 million in 1993 to \$1.9 billion in 2004. However, this was more than offset by a \$1.5 billion increase in the U.S. deficit in meat trade with Canada. In effect, all the gains from expanded meat trade accrued to Canada, and U.S. farmers, ranchers, and meat packers were left empty-handed.

Thus, U.S. trade with Mexico in agricultural and food products under NAFTA cannot be considered in isolation from trade flows with Canada. Overall, the U.S. deficit in agricultural products with Mexico and Canada swelled from \$400 million to \$1.3 billion, an increase of \$900 million, which is equivalent to a net loss of \$900 million in farm income over this period. The food products sector took an even greater hit, as the trade balance swung from a surplus of \$1.2 billion in 1993 to a \$2 billion deficit in 2004, a net loss of \$3.2 billion in revenue. This loss also significantly reduced the demand for U.S. agricultural products.

The USDA (1993a, 2) forecast that because of increased agricultural exports to Mexico, “[NAFTA] will add as many as 54,000 more jobs” in food processing. However, the United States’ \$1 billion surplus in food products trade with Mexico and Canada turned into a \$2 billion deficit, resulting in the net loss of 16,000 jobs in food processing alone (Scott and Ratner 2005, forthcoming).

Failed dreams

In addition to the overall failure of NAFTA to bring about the promised demand increases, a number of specific USDA predictions of great benefits for farmers have not been realized (USDA 1993b) . The U.S. trade surplus with Mexico in cash grains did increase by about \$1.4 billion, as noted above, but prices of key grains fell, as noted below. In addition, widespread losses throughout many other large segments of U.S. agriculture offset those gains.

Beef and pork

The USDA (1993b, 25-6) predicted that “U.S. exports of pork and hogs to Mexico are expected to double by the end of the transition period.” In addition, “U.S. hog and pork prices will likely rise a little, adding \$50 to \$100 million in revenues.” According to the USDA, NAFTA was expected to “increase trade in live cattle and beef between the U.S. and Mexico” and raise cattle prices by “\$.50 to \$1.00” per hundred weight.

The results were less than expected. Swine exports to Mexico did increase by about \$10 million. However, swine imports from Canada increased by \$450 million, overwhelming any marginal gain from increased trade with Mexico. Overall, the livestock (cattle plus hogs) deficit with Mexico increased from \$350 million to \$500 million between 1993 and 2004. The livestock deficit with Canada (adjusted for mad cow effects; see endnote five) increased from \$900 million to \$1.5 billion, for an overall decline of \$750 million in the livestock trade balance alone.

Commodity prices are highly variable, and year-to-year comparisons may miss underlying trends. Comparing three-year averages, lean hog prices declined \$8 per hundred weight, or 18% between the 1991-93 and 2001-03 periods (USDA 2005d). Beef prices were unchanged over this period.⁶

Corn and beans

The USDA (1993b, 3) predicted that corn exports would be 60% higher after NAFTA, and that prediction was accurate. However, USDA also said that “NAFTA is predicted to raise U.S. farm prices for corn about 6 cents a bushel.” In fact, prices farmers received for corn fell 8 cents per bushel, or about 3.3% between the 1991-93 and 2001-03 periods (USDA ERS 2005b). Likewise, the USDA predicted that oilseed farmers could expect “Under NAFTA, higher prices (USDA, ERS 2005c).” The prices farmers received for soybeans fell 10 cents per bushel, or about 1.7% in the same period.

Vegetables and melons

Although the USDA acknowledged that Mexico would “supply a wider range of vegetables year-round to the U.S.,” it claimed that “improved Mexican access to Canadian markets and the continued phase out of Canadian tariffs on U.S. exports will moderate the potential effect of phasing out U.S. tariffs for Mexico bilaterally” (USDA 1993b, 18).

The actual results after tariff liberalization have been anything but moderate. The U.S. trade deficit with Mexico in vegetables and melons increased from \$800 million in 1993 to \$2.2 billion in 2004. U.S. imports of many key vegetables and melons from Mexico soared during this period. For example, imports of asparagus (fresh or frozen) increased \$41 million (25%), cauliflower and broccoli imports increased \$59 million

(52%), strawberry imports increased \$73 million (107%), melon imports increased \$80 million (56%), and tomatoes increased \$446 million (47%) (USDA FASOnline 2005b). There was no offsetting change in the \$500 million U.S. surplus with Canada in this sector.

Sugar

U.S. sugar trade under NAFTA illustrates the difficulties of changing the management of this complex industry as part of a multilateral trade agreement. The USTR established a complicated schedule for easing Mexico's sugar quota under NAFTA. Importantly, sugar quotas were to vary depending on whether Mexico was a "net sugar importer," in which case its quota would be much more limited. The USDA noted that "income growth in Mexico is expected to expand the demand for sugar," and although "it is uncertain to what extent Mexico might achieve a net production surplus...any net production surplus would likely develop gradually" (USDA 2003b, 14).

Similarly, the USTR (2005a) has asserted that "increased [sugar] imports in the first year under CAFTA [will] amount to...a spoonful a week." Implementation and management of the sugar quota was one of the most contentious issues in the NAFTA process. As noted by the Congressional Research Service (CRS), the "importance of this matter is reflected in the fact that sweetener issues have been frequently discussed at meetings held by both countries' presidents since the late 1990s" (Jurenas 2004, 13). The issue was so significant that it was the subject of a side letter dated November 3, 1993, after NAFTA had been signed by the presidents of the three countries, concerning the definition of a "net production surplus" of sugar in Mexico. The Mexican Congress has insisted on adhering to the text of the original agreement.

The sugar battle has expanded to include high fructose corn syrup (HFCS), which is widely used as soft drink sweetener in the United States. At one point, the Mexican Congress imposed a 20% tax on soft drinks containing HFCS, which effectively banned HFCS made by U.S. producers operating in the United States or Mexico.

The resulting changes in sugar trade are instructive. The U.S. moved from essentially balanced trade with Mexico in sugar and confectionary products (a food industry sector) in 1993 to a deficit of about \$200 million. The effects of NAFTA were even larger with Canada, where a \$100 million surplus in 1993 turned into a \$700 million deficit in this industry in 2004. Thus, U.S. sugar producers experienced a net decline of \$1 billion in the sugar trade balance in this period. In 2001 and 2002, the U.S. sugar industry encountered a "sugar oversupply situation, which resulted in historically low sugar prices and subsequent forfeiture of sugar pledged as collateral for price support loans to USDA" (Jurenas 2004, 1).

The bottom line: Farm incomes

The USDA (2003, 4) predicted that NAFTA would increase farm cash receipts "by about 3% compared to projections without NAFTA." Like commodity prices, cash receipts are also subject to cyclical variations. The USDA also stated that "NAFTA is also expected to reduce farm program payments" (USDA 2003, 4). An examination of receipts, incomes, and government expenditures over three-year periods ending in 2003 (the last year for which complete data are available) reveals an overall decline in farm cash receipts and net farm income.

Farm cash receipts for crops and livestock declined from an average of \$101.1 billion (in real 2000 dollars) between 1991 and 1993 to \$97.9 billion in the 2001-03 period, a decline of 3.1%. Many farm programs were significantly changed or converted into direct income support programs in the 1996 and 2002 farm bills, so it is appropriate to consider all direct government payments as a base of comparison. Between the periods from 1991-93 and 2001-03, direct government payments accelerated on average from \$11.8 billion to \$15.3 billion, an increase of 29.1%.

The USDA (2005a) did not forecast net farm income, perhaps the most important variable of all to the farm community. Between 1991-93 and 2001-03, net farm income declined from \$52.7 billion (in real 2000 dollars) to \$47.0 billion, a drop of 10.8%. A better barometer of the health of the agricultural sector is provided by net farm income less direct government payments, which fell from \$40.9 billion (in real 2000 dollars) to \$31.8 billion, a decline of 22.3%. Without this substantial increase in government payments, even more farm families would have fallen victim to hardship and bankruptcy.

Conclusion

In the wake of NAFTA, farmers, ranchers, and food producers have suffered stagnant or rapidly worsening trade flows, falling prices and revenues, declining incomes, and a long string of failed promises. These agriculture producers have been caught in a tangled web of political intrigue and international trade disputes that have had a largely negative effect on U.S. trade. The NAFTA experience has damaged the credibility of the USTR, the USDA, and several presidential administrations. If there is a lesson to be learned from NAFTA's failures, it is that today's claims of great CAFTA benefits should be taken with a grain of salt.

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Endnotes

1. The U.S. International Trade Commission (USITC) makes the trade data collected by the Department of Commerce, U.S. Census Bureau readily available online in 2004 in a wide variety of formats. Agricultural products are defined here as North American Industry Classification System (NAICS) industries 111 (agricultural products) and 112 (livestock and livestock products), and Standard Industrial Classification (SIC) industries 11 through 18 and 21 through 27.
 2. PPI, 2001 data. Presumably this refers to measures of output calculated using purchasing-power parity (PPP) price indices.
 3. El Salvador has formally linked its currency to the dollar (dollarized).
 4. The trade measures used in this study are “consumption imports,” defined as the portion of general imports destined for domestic use, and domestic exports, which are goods exported that are produced in the United States. While the levels of consumption and general imports are nearly identical in U.S./ NAFTA trade flows, total exports are about 10% greater than domestic exports. The difference, foreign exports, is accounted for by goods originating in other economies that are shipped through the United States to Canada and Mexico.
 5. All trade data referred to in this report are from USITC 2005 unless otherwise noted. The estimated agricultural trade deficit with Canada in 2004 includes an imputed value for animal imports in the absence of the mad cow disease ban on cattle instituted in 2003. U.S. cattle imports from Canada declined from \$1.2 billion in 2002 to essentially \$17 million as a result of the U.S. ban on cattle imports. It is assumed here that trade will resume the former pattern once the medical restrictions have been lifted.
 6. Reported prices are from USDA 2005d, tables 59 and 73.
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