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# Market and Policy Integration in Times of Crisis



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## INTRODUCTION

For years following the creation of NAFTA, consistent progress was made in the direction of increased market integration (Doan *et al.*). Since 2002, however, there have been a number of serious setbacks indicating that basic NAFTA strategic and procedural issues need to be addressed by all three member countries. A primary example of these setbacks would be the impact of the 2002 US farm bill, which institutionalized unprecedented levels of US agricultural subsidies. This set off a new spiral of increased producer support with a dedicated effort from Mexico to match US levels of support among some of its staple crop producers. Another example of a NAFTA setback is the unrelated series of livestock and meat market closures, which might not have happened if proactive, decisive, and comprehensive trilateral NAFTA action had been taken following the first Canadian case of Bovine Spongiform Encephalopathy (BSE) in 1993. When the United States placed a countervailing duty on swine imports from Canada for protectionist reasons in 2004, again the spirit of NAFTA was violated. While these various anti-free trade actions might be attributed to individual spurious events, there are two, alternative strategic and procedural explanations that are of great concern and require the serious attention of policy-makers:

1. North America may be experiencing a new wave of protectionism that could directly inhibit the process of market integration and other initiatives leading to freer trade.
2. Basic flaws may exist in how NAFTA has been implemented. The absence of both a solid commitment to the Agreement, and a formal planning and management system make the deficiencies in North American integration even more evident.

Both of these explanations raise serious questions concerning the effectiveness of NAFTA and the requirements needed to achieve further market integration. The purpose of this chapter is to present some conclusions that can be drawn from the discussions at the Second North American Agrifood Market Integration Consortium (NAAMIC) workshop, which addressed issues concerning the BSE crisis in North American beef/cattle markets and NAFTA agricultural policy developments. This will be accomplished by first pointing out a number of realities concerning NAFTA and the process of market integration, then recommending required actions, and finally drawing conclusions.

## **REALITIES**

Despite the recent, divisive issues, evidence clearly indicates that while still needing to adjust in many different ways, each of the member countries have benefited from NAFTA. They have benefited in terms of markedly increased trade reflecting the comparative advantage of each country. For example, since the inception of NAFTA, US grain exports to Mexico have more than doubled to support the expanding livestock industry there, while Mexico has dramatically increased exports of fruits and vegetables to the US to fulfill its increasing demand for fresh produce, and finally, through the use of green house technology, Canada has also taken a share of this demand growth in the US (Zahniser).

These benefits have been realized despite limited progress in achieving harmonization in important areas of regulation and agricultural policies that directly impacted trade and trading relations. Indeed, NAFTA's benefits would be significantly enhanced and future conflicts avoided if the following realities were fully recognized and addressed.

### **Greater Problem Complexity**

Understandably, the initial trade distorting issues dealt with under NAFTA were the simplest ones, which generally affected smaller segments of the agricultural economies of the member countries, and were not perceived to have large, direct impacts on many producers. The NAFTA's treatment of US avocado imports and the harmonization of pesticide regulations fall in this category. Even cattle and beef trade initially benefited from NAFTA until the potential adverse affects of BSE on both animal and human health became an issue.

Many of the remaining issues for NAFTA agrifood trade deal with larger and more complex agricultural subsectors, as well as those where substantial structural adjustment is already occurring. This has caused increased tension and controversy among producers from the three member countries. For example, the hog industry is undergoing major,

integrative structural change resulting in negative competitive effects being experienced by those producers who have chosen, for one reason or another, not to become a part of integrated systems. Often, these producers blame changes in trading relationships, globalization, and integrating firms with multinational dimensions for the price declines that in reality result from cyclical market patterns.

In the case of agricultural policy, there is a perception that substantial structural changes would be the result of policy changes, thus automatically putting producers in a defensive position. This is the case with sugar, where Mexico is perceived to have a comparative advantage in cane sugar production, while the United States has pursued corn sweetener (HFCS) production. Opening the US sugar and sweetener market to increased sugar imports from Mexico would injure higher cost US producers while benefiting Mexican sugar producers. Likewise, substantially reducing US agricultural subsidies on grains or abandoning Canadian supply control programs in dairy and poultry production runs the risk of greatly reducing producers' profits and asset values.

Understanding these causal relationships and the potential impacts of any changes to their current status is crucial to understanding the origins of conflict and how to avoid adopting adverse policies that disrupt trade. None of the NAFTA partners is devoting sufficient resources to help higher-cost producers adjust to freer trade which exposes them to competitive pressures from lower-cost producers in their NAFTA counterparts.

### **Protectionism Threat**

It needs to be recognized that the threat of protectionism is constantly present. There are always advocates who stand to realize benefits from increased protectionism. These may be populist politicians or deceitful lawyers intent on convincing producers that the costs of trade are greater than the benefits, or that the long-run benefits of trade will never be realized. Protectionists and protectionist policies need to be directly confronted by the NAFTA stakeholders (including academics and policy-makers) for what they are. At the same time, it is crucial that programs be adopted to help producers adjust to change when faced with the increased competition resulting from freer trade.

### **Greater Global Competition**

The competitive position of the North American agricultural sector is increasingly being challenged by other countries. The current focal point of US concern is the advantage Brazil has in the production of soybeans and pork, and Argentina's comparative advantage in corn and

beef production. Equally important are the longer-run challenges posed by Eastern European countries, China, Southeast Asia, and others. We believe each North American country faces bigger challenges to its global competitiveness from outside, rather than from within NAFTA. Therefore, each of the NAFTA countries can benefit more by working together to improve external competitive relationships rather than bickering over the internal challenges.

### **Fighting NAFTA Myths**

Those adversely affected by freer trade inevitably look for a mythical scapegoat to blame for their situation. These myths are ever present and must be treated as such. For example, it is a myth that industry concentration and its monopolistic consequences have been fostered by NAFTA. NAFTA, like globalization and the World Trade Organization (WTO), broadens the scope of the market, decreases monopolistic forces, and enhances competition. The problem arises not from monopoly, but from exposure to competition from lower-cost production systems. Advocating otherwise reflects a protectionist philosophy that arguably is the driving force of many policies. Time and again, studies have shown that monopolistic effects have declined as globalization and freer trade have expanded. This is reflected in an observed decline in antitrust activity (Mercier; Knutson *et al.*; Sumner; Zoellick).

It is also a myth that NAFTA has been the compelling force for large companies to become directly involved in agrifood production through either contracts or ownership. Vertical integration in agriculture began long before NAFTA and has progressively increased as agribusinesses and food retailers strive to reduce costs and manage their supply chains. The need for food processors and retailers to exercise increased supply chain management has accelerated with the acknowledgment of the need to reduce the risk of food-borne disease, contamination, and agroterrorism.

Finally, it is a myth that NAFTA is responsible for increased poverty. Trade reduces poverty by increasing employment opportunities, as output in sectors with comparative advantage expand through trade, and by reducing living costs for consumers through cheaper imports. Likewise, it is erroneous to assert that agricultural programs can be used to reduce poverty. The solutions to poverty lie in governments investing in education, retraining, relocation, and infrastructure – not in agricultural subsidies.

## REQUIRED ACTIONS

To achieve the full potential from market integration under NAFTA, actions must be taken to extend its current scope. The following list is not intended to be comprehensive, but includes those actions that received attention and consideration for implementation in this workshop.

### Increased Understanding

The above discussion of the myths associated with NAFTA, freer trade, and the related protectionist reactions indicate an overwhelming need for increased understanding of the short- and long-run consequences of policy decisions and of the actions taken to implement them. A case that clearly demonstrates this need is that of R-Calf (Ranchers-Cattlemen Action Legal Fund) and its behavior in the current BSE situation (Sparling and Caswell discuss this case in greater detail). By extending the closure of the US border to Canadian animals, this small number of ill-informed cattle ranchers may realize short-term benefits in the form of higher feeder and stocker prices, but in the longer-term they will experience increased instability and substantially lower prices due to over-expanded production when markets eventually reopen. These ranchers will then blame their plight on NAFTA, rather than recognizing that their own, short-sighted actions are the cause of their troubled situation. The only guards against such irrational behavior are continuing education and information efforts, and the election and appointment of policy-makers who have the common sense and statesmanship to do what is right.

### Crisis Planning

NAFTA badly needs a trilateral management and planning system to deal with crisis situations. While this need may not have been apparent at the time NAFTA was approved, it is woefully clear today following the experiences with BSE and the recent threats of bioterrorism. The current emphasis in dealing with issues on the basis of sound science is justified and has been accepted by the WTO and the World Health Organization (WHO) as the international standard. A truly proactive approach to address more complex issues, such as anticipating threats, crisis planning, and costly issues of getting the NAFTA countries to adopt comparable levels of technical inspection, surveillance, and enforcement, needs to be more aggressively pursued. This inherently involves agreeing on and clarifying the roles and responsibilities of NAFTA and its individual members in dealing with crisis situations.

## **Policy Consequences**

A basic inadequacy of NAFTA is the lack of a framework for analyzing the impacts of policy changes on North America and its individual member countries. The result is that, while the United States and Canada conduct analyses of the impacts of policy changes for their own policy making purposes, the impacts on North America as a whole and their NAFTA partners are not analyzed and are not transparent to the other countries' stakeholders and policy-makers. This results in aggregate and individual country impacts of policy changes receiving no consideration, at worst, or inadequate consideration, at best. In addition, the lack of information on the positive consequences of policy decisions creates the opportunity for spreading populist fears about free trade and protectionism. Transparency, as a key to making sound policy decisions, requires knowledge of the policy impacts for NAFTA as a whole, as well as for the individual member countries. An independent, trilateral policy analysis institution could perform this function (Meilke and Sarker).

## **NAFTA Policy Position**

NAFTA needs to stand internationally as one entity. In contrast to most of the other WTO negotiating blocs, the NAFTA partners have not taken a common position on an issue such as agricultural policy. Yet Canada and the United States generally are recognized as two of the four countries that have had a major impact on the outcome of past negotiations; the other two being the EU and Japan. Mexico, Canada, and the United States each participate in other blocs with some membership overlap and with varying negotiating positions. We believe that NAFTA's reliance on the WTO to settle its agricultural policy disputes, and its lack of an international trade position of its own is short-sighted and reflects a basic NAFTA weakness.

## **Adjustment to Change**

While freer trade yields overall economic and food security benefits to agriculture and society as a whole, certain segments of the agricultural economy inevitably will be disadvantaged. Normally, these are segments whose access to the domestic market is protected by specific policies and which cannot compete fully in the broader NAFTA market. Under freer trade, resources, including human resources, may need to be provided with assistance to adjust to their best use considering the new policy environment. We believe that current policies need to be redesigned to address these adjustment issues instead of providing ever higher levels of subsidies to producers who cannot compete in a global market economy. This may require compensation and retraining programs that have seldom been utilized in agriculture.



## SUMMARY AND CONCLUSIONS

Some conclusions that can be drawn from this workshop on how NAFTA can continue its integration efforts in agrifood trade are summarized in the following points:

1. Greater commitment to the NAFTA process must be shown by both policy-makers and members of the agrifood industry. Active industry and academic participation and collaboration in the creation of agrifood trade policy and regulations would also be beneficial.
2. Emphasis on proactive crisis management and planning is necessary to ensure further harmonization efforts on science-based regulatory mechanisms to allow movement into more complex agricultural issues.
3. There is a need to push for the development of common NAFTA positions at international fora like the WTO.

In agriculture, NAFTA has been a success story that that we believe can produce results of even greater magnitude. These results will require initiatives and short-run sacrifices on the part of each member country in order to remove the current obstacles to expanded trade and economic growth, yielding greater benefits in the long-run. The consequences of not taking these actions are continued stagnation of benefits, increased protectionism, increased tensions, and reduced support for NAFTA.

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