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BACKGROUND AND PURPOSE OF THE WORKSHOP

“Structural Change As A Source Of Trade Disputes Under NAFTA”

R.M.A. Loyns, Karl Meilke, Ronald D. Knutson and Antonio Yunez-Naude

The potential for structural change in agriculture is an important and largely unexplored factor affecting progress toward freer trade and a source of trade disputes. While substantial gains from trade in terms of increased efficiency and growth have been realized, there appear to be inherent concerns among farmers, laborers and some agribusinesses that they will be reorganized or displaced, that production will be relocated, that economic rents that may have existed in a protected market will disappear, and that the nature of agriculture, including its institutions and culture, will be forever changed. This potential for structural change is believed to be a substantial reason for protests by farmers against NAFTA and its perceived effects. At the same time, there are many farmers and agribusinesses who view NAFTA as creating opportunities to adjust crop mixes and business operations into more profitable and more efficient configurations.

NAFTA has had a direct impact on market structure by making exports a new competitive variable and providing the potential for continued export pressure. For some agricultural commodities, NAFTA has created major changes in trade flows, benefitting new sellers in exporting regions but causing production relocation or reorganization stress for importing country producers. There is evidence that these increased trade flows have been the cause of some trade

disputes. But there are also indirect and less obvious impacts on market structure. Past workshops have suggested that NAFTA, in combination with other market forces, has resulted in:

- geographic expansion of markets and market activity;
- increased vertical and horizontal combinations of business activities;
- elimination of some government programs and associated marketing institutions;
- harmonization of infrastructure support facilities and systems used in conducting business; and
- globalization of business and market planning

Previous workshops and other research have not systematically analyzed the structural changes associated with these developments. In addition, the final provisions of NAFTA excluded trade-oriented changes in major aspects of domestic farm policy resulting in many aspects of the agriculture and agri-food industry remaining subject to substantial government intervention. In other words, the “free trade agreements” have substantially altered many aspects of market structure and produced freer trade in much of the agriculture and agri-food industry in Canada, Mexico and the United States but certainly has not produced a genuine or full-free trade structure.

Genuine free trade has the potential for significantly changing the nature of competition in agricultural markets and the agri-food sectors. These changes may be either positive, as a larger number of firms come into cross-border competition with one another, or negative, if incentives for mergers and acquisitions are strong enough to actually reduce competition. The linkages between freer trade, structural change, and competition are not immediately obvious, and there are almost sure to be distributional effects from these changes that create gainers and losers. To a significant extent, the tensions and unanswered questions associated with these changes may result from a fear of the unknown, they may be unfounded, but they are real.

The purpose of this workshop on *Structural Change as a Source of Trade Disputes Under NAFTA* was to provide a thorough analysis of the relationships between NAFTA and structural change, and to answer questions re-

garding the impacts of free trade on structure and competition within agriculture and the agri-food industry. It is essential in undertaking such an analysis to recognize that there are three levels of structure and industry organization to be considered, not two as conventional wisdom might suggest. First, it is relatively easy to describe conditions prior to the “free trade agreements”; that is the subject of historical analysis. Second we know, or we can determine, where we are after several years of the operation of “free trade” as defined by CUSTA and NAFTA; this is the second level of free trade analysis. What is most difficult to know, and it requires some forecasting to analyze, is where we would be in the structural, locational, competition, and trade dispute picture if we had genuine free trade within the NAFTA region. *Analyzing these three levels of free trade effects was the basic objective of this workshop.*

For purposes of our analysis, we asked authors and participants to use the following definitions of ‘structure’, ‘competition’, and ‘free trade’:

Market Structure. As this term is used in economics, it refers to the basic organization of an industry and the inherent market characteristics of that industry. Several components are specified to describe market structure:

- number of buyers and sellers, and their size distribution;
- amount of product differentiation;
- barriers to entry;
- cost structures, particularly importance of fixed or sunk costs;
- extend of vertical integration;
- conglomerate integration and other business linkages; and importantly
- regulations, subsidies and other forms of government influence including, in this analysis, NAFTA arrangements.

This definition of structure is derived from the literature of industrial organization and provides a useful conceptual framework for analysis of markets and change in market organization. It was originally developed to describe and analyze business organization in the manufacturing and industrial sectors of a modern economy but it is believed to be equally applicable to agriculture as specified here. For purposes of this workshop, the relevant markets and related structures include the farms themselves, the supply of inputs to farmers, the configuration of processors who purchase products from farmers, and other

levels of the agri-food industry such as further processing, food service and retailing.

Competition means different things to different people. However, to economists and as used in this workshop, *competition* refers to the *intensity of rivalry among firms*. When competition is keen, information is full, and there are no externalities, efficiency of production and processing is promoted; consumer demands are satisfied; progressiveness and investment are fostered; and normal profits consistent with performance and management capabilities are achieved. Conventional wisdom asserts that competition in agriculture and agri-food markets is enhanced by free trade agreements such as NAFTA. Two important dimensions of competition for our analysis include:

- competition of firms within and among the NAFTA countries; and
- competition of firms between the NAFTA countries and the rest of the world.

Another term, *competitiveness*, has crept into the literature in recent years. It appears to derive from the issue of whether, under conditions of freer trade, the products and producers of one country can survive in the face of competition (i.e. rivalry) imposed by another country. In relation to traditional economic theory, *competitiveness* should be interpreted in relation to *the amount of competition* required to get acceptable performance in terms of not generating excess profits or distorting resource allocation. The objective of this workshop was to deal with competition as an instrument or process of business rivalry and as a tool for improving economic performance in markets.

Free Trade as used in the workshop, was intended to mean *the absence of governmental institutions (policies, programs, and regulations) that impede trade within and among the NAFTA countries*. This would involve the elimination of regulation and many institutions that restrain or act as barriers to trade but are currently legal under the terms of NAFTA. Such institutions include governmental subsidies to farmers (domestic farm programs), marketing boards and orders that have market regulatory powers, supply management programs, and trade restricting remedies through institutions such as the U.S. International Trade Commission (USITC) and its counterparts in Canada and Mexico. The term would not likely include governmental programs/institutions consid-

ered to be “green” under the provisions of the World Trade Organization (WTO) such as publicly supported research, extension, food safety (HACCP) regulations, grade standards, prompt-pay provisions, price reporting, etc. The last paper identifies the issues in determining what government policy and programs might be acceptable in a free-trade environment, and discusses those institutions considered important to promoting competition under free trade.

This publication contains most of the papers and discussion comments presented at the workshop in Tucson in February, 2001. Papers have been edited only to produce a common format and consistent style of presentation. Each section includes an overview of comments made in our open discussion sessions. The workshop was organized to first present an overview of evolution of market structure and competition since, and in response to, the ‘free trade agreements’. The next sessions were directed to tracing the evolution of these factors for the livestock and crops sectors, and attempting to project how genuine free trade might influence market organization. The final paper provides an overview of existing government policies and programs in the three NAFTA countries and indicates compatibilities and inconsistencies with genuine free trade.

Section 1

Structural Parameters for the Agri - Food Industry Within NAFTA

*The objective of this section
is to present structural data
and analysis on the agri-food
industry within the NAFTA
region.*