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## CANADA-MEXICO AGRI-FOOD TRADE UNDER NAFTA

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### SUMMARY

This paper outlines the trade in agri-food products between Canada and Mexico under the North American Free Trade Agreement (NAFTA). A detailed description of the pre-and-post NAFTA structure of trade barriers is presented. It is found that trade has increased significantly in most agri-food sectors under the new agreement. This suggests that NAFTA achieved its stated goals of lowering barriers to trade between these two trading partners.

**KEY WORDS:** North American Free Trade Agreement (NAFTA), quota, tariff, duty, tariff rate quota (TRQ), liberalization, agri-food

### INTRODUCTION

The North American Free Trade Agreement (NAFTA) is a trilateral trade agreement between Canada, Mexico, and the United States. Designed with the objectives of promoting trade liberalization, improving the climate for investment, providing a mechanism for the resolution of disputes over subsidies and countervailing duties, and creating new rules to govern trade in financial services, NAFTA has been heralded as a promising marriage of Canadian resources, Mexican labour, and U.S. capital and technology (Vaghefi). As well, the formation of a North American trading bloc was seen by some as a necessary strategic reaction to the formation of similar alliances in other parts of the world.

NAFTA was born out of a June 1990 formal agreement between Mexico and the United States that a free trade agreement could be mutually beneficial to the two countries (Segarra). Soon after, in September of that year, Canada expressed interest in becoming part of an accord. By February of 1991, all three governments had agreed that the trilateral agreement should be undertaken, and formal negotiations toward NAFTA began on June 12. The formal agreement was signed on August 12, 1992, and took effect on January 1<sup>st</sup>, 1994.

Though NAFTA is rarely described other than as a single agreement, it is actually comprised of three bilateral pacts among the member countries, including the pre-existing Canada-U.S. Trade Agreement (CUSTA), which was absorbed into NAFTA. Strictly speaking, then, only the agreements between Mexico and each of the its two partners to the north were “new” under NAFTA. Puche notes that NAFTA was part of the ongoing evolution of Mexican trade policy from a discretionary system based on import permits and quotas to a general system based fundamentally on tariffs. He observes that the agreement was attractive to Mexico

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because that country was failing to take advantage of proximity to large and lucrative U.S. goods markets, and that Canada and the U.S. could similarly benefit from the desire of Mexican consumers for North American products.

With respect to trade in agricultural products, it was thought that the agreement would magnify existing trade patterns, especially between Mexico and the United States (Grennes and Krissoff). Predictions on the resulting welfare effects of the new agreement on each of the countries were varied; Josling notes that general and partial equilibrium, as well as commodity-specific studies were carried out. Most concluded that welfare would increase for Mexican and American consumers as well as American producers (with the notable exception of U.S. fruit and vegetable producers), but that Mexican producers would see their surplus decrease.

A NAFTA pact with Mexico signaled a switch in Canada's trade policy into an active regionalist phase after a long history of multilateralism (Weston). Trade with developing countries was increasingly based on reciprocity, regardless of developmental differences. Prior to NAFTA, Canada-Mexico trade was small, consisting mostly of grain going from Canada to Mexico and fruits, vegetables, and coffee traveling in the opposite direction. Under the agreement, Mexico protected its corn industry from unfettered competition, but in return did not receive full access to the fruit and vegetable markets of its new trading partners. It is also noteworthy that Canada's supply-managed sectors (dairy, poultry, and eggs) were excluded from NAFTA. As such, though the agreement was termed "free trade" among the member countries, some of the most important sectors within each were spared from serious competition from partner countries' producers.

Though extensive discussion of the effects of NAFTA on Mexico-U.S. agricultural trade have been undertaken at various stages of its implementation, little effort has been undertaken on the analogous Canada-Mexico front. Study of the influence of NAFTA on agricultural trade between the two countries is important for two reasons: first, to discover whether the agreement had the intended effects on bilateral trade, and second, to help Canada in planning for further rounds of international trade negotiations. The purpose of this paper, then, is to provide an overview of how Canada-Mexico trade in agricultural products has evolved under NAFTA. It is well-known that bilateral trade between the two countries has increased since the implementation of NAFTA (Figure 1); this paper provides an overview of how trade between the two countries has evolved in specific agri-food sectors.

The paper proceeds as follows: first, the data sources used herein are outlined. Next, a sector-by-sector analysis of the changes to barriers to Canada-Mexico trade in agricultural products is given, including a discussion of pre-and-post NAFTA tariff barriers and an overview of changes in trade flows for each major sector. A summary and conclusion section completes the paper.

## **Data**

Data for trade flows in the following section were either obtained from Statistics Canada Catalogues 65-004 (merchandise exports to Mexico—CANSIM matrix 3711) and 65-

006 (merchandise imports from Mexico—CANSIM matrix 3912) or, for more disaggregated data, from Industry Canada's *Strategis* database. Pre-NAFTA and other trade barriers are taken

from USDA-ERS; additional information on border measures for Canada is taken from Agriculture Canada (AAFC). As well, USDA-FAS attache reports provided some of the data on Mexican border measures.

### **Sectoral Analysis**

Unlike agricultural trade between Canada and the US that increasingly consists of roughly equal two-way flows of similar processed products, trade flows between Canada and the Mexico are one-sided and can be explained by conventional arguments of comparative advantage. Mexico exports labor intensive goods such as horticultural products, and Canada exports land intensive products such as grains and oilseeds. Commodities have traditionally dominated Canada's exports to Mexico; nonetheless, the degree of bulk dominance is changing. In 1995, the share of Canadian exports of bulk products relative to total exports was 65%; by 2001 it had dwindled to 42%.

Canada imports a wide variety of fruits and vegetables from the Mexico, but its top import is beer, followed by tomatoes, guavas and mangos, peppers, and avocados. Canada's leading exports to Mexico are canola, wheat, beef cuts, skim milk powder and canary seed.

Figure 2 shows the annual value of Canadian exports to Mexico for meats, cereals, oilseeds, dairy and other agricultural products for the period 1980 to 2002. The annual value of Mexican exports to Canada of fruits and vegetables, coffee and tea, alcoholic beverages, confectionary items, and other food and beverages is represented in Figure 3. These two figures show an increase in trades volume prior to the implementation of NATFA in 1994; in some cases the growth rates have increased significantly since that point in time. A detailed analysis of several the most important sectors is presented below.

#### Oilseeds

Prior to NAFTA, Canada had tariffs of 7.5% on soybean oil and 10% on other vegetable oils, but it did not have duties for soybeans, canola, soybean meal or other meals. Before 1994, Mexico levied a seasonal tariff of 15% on U.S. soybeans, as well as tariffs of 15% on soybean meal, 10% on crude soybean oil, and 20% on refined soybean oil. The phase out of Mexican tariffs ended on January 1, 2003.

Mexican vegetable oil demand is primarily satisfied by domestically produced oil crushed from imported oilseeds. Canada has taken advantage of the growing demand for oilseeds, more than tripling the volume of canola exports between 1993 and 2002, a period during which the annual growth rate for total Canadian exports of canola was 8%. Mexico has become Canada's second largest market for canola.

Expansion of Mexican soybean area is limited by both credit and moisture constraints. On the demand side, a dynamic livestock sector has contributed to growing consumption of protein meals. Between 1994 and 2002, Mexican protein meal consumption increased by 80%, and since oilseed demand is elastic, price will continue to be the overriding factor in marketing

oilseed products. Most Mexican vegetable oil consumption goes into food processing and oil blending industries (USDA-FAS).

### Red Meats

As of 1992, Mexico had no tariff for fresh and frozen beef. Late in that year, Mexico raised its beef tariffs from zero to 20% for fresh beef and to 25% for frozen beef. These tariffs were eliminated with the introduction of NAFTA for Canadian and U.S. beef. Mexico also levied a 20% tariff on beef offal, which was finally phased out on January 1, 2003. Prior to 1994, Mexico levied a duty of 20% on most pork imports. Under NAFTA, the duties were phased out over the 9-year period ending on January 1, 2003. A safeguard quota was placed on certain cuts of pork. If imports rise above that level, the duty reverts to the lower of the current most-favoured nation (MFN) or pre-NAFTA levels.

NAFTA also eliminated a 15% duty on Mexican imports live cattle imports and 20% duty on non-purebred hogs (phased out on January 1, 2003). In addition, a safeguard tariff rate quota (TRQ) was placed on imports: if imports rise above the levels specified by the TRQ, the duty reverts to the lower of the current MFN or the pre-NAFTA level. The safeguard provision expires on January 1, 2003. Pre-NAFTA Canadian tariffs affecting beef trade were relatively minor (ranging from 2¢/lb to a 4% ad valorem tariff). Live cattle tariffs were 1¢/lb. Canada did not assess a tariff for live hogs or fresh or frozen pork.

While pre-NAFTA tariffs for livestock and red meats were not very large, a number of non-tariff barriers affected trade flows. These non-tariff barriers include: i) trade remedy laws; ii) health and sanitary regulations; and iii) consumer labeling and associated regulations. For instance, Mexico requires that all imports of fresh, chilled or frozen meat receive prior authorization by the Secretariat of Agriculture. NAFTA has done little to reduce these non-tariff barriers to continental meat trade. Given the tight logistics of meat supply chains, border inspections and other administrative delays mean reductions in quality and may place the reliability of the exporter in question.

In the decade since NAFTA was signed, Canadian meat exports to Mexico have grown by an annual rate of 40% to almost \$300 million. The increase in beef exports has been the most dramatic—in the period since 1997, beef exports to Mexico have increased exponentially from \$4 million to \$8 million to \$40 million to \$125 million to \$200 million.

Over the decade, Canadian pork exports increased from \$20 to \$40 million. In 2001, over half of this trade was in edible swine offal. The share of pork to total meat exports has declined from 88% to 18% over the last decade. Part of this shift in meat exports away from pork towards beef can be explained by increased Canadian processing capacity. But hog production and processing capacity has also increased, so why have beef exports come to dominate Canada's meat trade with Mexico? Mexican use of contingent protection measures—anti-dumping duties against US pork and a safeguard action against pork—possibly has discouraged pork exports by Canada. Mexico is likely to continue importing grain-fed beef to meet demand from the tourist and restaurant sectors as well as from the general population (USDA-FAS).

Mexican beef import demand is partially driven by a continued drought in the north that is keeping animal numbers down. As well, yearly beef consumption continues to grow

with an expanding middle class. The increase in Canadian exports can also be explained by supply factors in Canada. The elimination of a transportation subsidy (Western Grains Transportation Act or WGTA) resulted in a decline in feed grain prices in western Canada.

This resulted in a significant expansion in the cattle inventory (11.8 million in 1994 to 13.3 in 2003). Changes in the Canadian slaughter industry have also had an impact on beef trade. U.S. ownership in the Alberta slaughter sector has resulted in additional investments and expanded capacity to export. Canadian beef slaughter in federally inspected plants increased from 24 million in 1993 to almost 33 million in 2002.

Canadian imports of beef and pork from Mexico are negligible, due to the large transport distance between the two countries. Live animal trade has remained relatively stagnant between Canada and Mexico with some modest growth of Mexican imports from a very small base.

### Grains

Prior to NAFTA, Canadian grain tariffs were relatively modest, ranging from 5 cents per bushel for corn and barley to 12 cents per bushel for wheat. Until the 1993 WTO Uruguay Round Agreement on Agriculture, Canada maintained licenses on wheat and wheat products. These import licenses were replaced by a system of TRQs for wheat, barley and products derived therefrom.

Mexico also had import licenses for wheat, oats, barley and corn. With the implementation of NAFTA these licenses were eliminated for North American grain trade. In the case of barley and corn, a system of TRQs replaced the import licenses and Canada received a small share of these quotas—1,000 metric tonnes for corn and 30,000 metric tons for barley and malt—however, Mexico's expanding beer industry encouraged the Mexican government to issue additional import licenses for malting barley. A relatively long 14-year transition period applied for the phasing out of the corn TRQ, but the barley TRQ was to be eliminated by 2003. Mexico's base tariff on barley was the greater of 128 percent or 15.5 cents per kilogram, while its base tariff on malt was the greater of 175 percent or 21.2 cents per kilogram. Mexico applied a 10 percent tariff on oats to be phased out by 2003. Mexico phased its 15% wheat tariff by 2003.

In the period from 1993 to 2002, Canadian exports of cereal grains grew at an annual rate of 19%, with wheat making up over 90% of these exports. Over the last decade, wheat exports grew at an annual rate of 8%. Milled cereals and other grains grew at a faster rate (40%) but made up only a small share of Canada's grain exports. The volume of oats exports increased seven-fold between 1993 and 2000, but the value of trade is still less than a million dollars.

Most Mexican wheat land is irrigated. Since 1996, Mexico's wheat area has generally been lower than it was from the period 1982-95 because of the increasing opportunity cost of alternative uses for the irrigated land (USDA-ERS 2002). Wheat consumption continues to grow because of an increasing population and a growing economy. There has been intense competition between Canada and the US for the Mexican market; Mexico is Canada's 4<sup>th</sup> largest market for wheat and the value of Canadian wheat exports to Mexico has grown from \$130 million at the start of NAFTA to around \$200 million for the last three years. Canada's

ability to export depends on its supply of wheat, which is steadily increasing. In 1995, Canada eliminated the WGTA, which provided a transportation subsidy for western grains. The effect of the transportation subsidy was to keep prairie farm prices above what they would have been at full rates (roughly a \$15 tonne difference). The elimination of WGTA created an incentive to

shift cropped area into the production of higher valued crops (special crops and oilseeds), and feed western Canadian grain for livestock production. There is also an incentive to ship grain to North American markets rather than to off-shore destinations.

There has been a rapid increase in exports of specialty grains such as canary seed. The annual growth rate in canary seed exports has been 12% over the last decade, with exports valued at \$31 million in 2002. The main importing countries for canary seed, in descending order, are Mexico, Belgium, U.S, Brazil, and Spain. Mexico's share of Canada's total exports has grown from 16% in 1993 to 27% in 2002. Mexico is Canada's sixth largest market for lentils. The average growth rate of the value of lentil exports over the last decade was 17% with the value of Mexican imports at \$10 million in 2002.

NAFTA also established a separate TRQ for Mexico's dry bean imports from Canada. Canada gained an initial duty-free quota for 1,500 metric tons of dry beans for 1994. The annual growth rates for Canada's quota, the initial level of the over-quota tariff, and the over-quota tariff phase-out are the same as those set for the United States.

#### Horticulture

Over the last decade, Canada's imports of fruits and vegetables from Mexico grew at an annual rate of 9%, with the value of imports reaching \$342 million in 2002. This is a difficult sector to assess, given the heterogeneity of different types of fruits and vegetables. Rather than attempt to provide a comprehensive assessment of this sector, only selected commodity assessments will be described.

The primary issue for horticulture in NAFTA was market access. Due to the nature of the products, many of the tariffs were seasonal. Prior to NAFTA Canada had seasonal tariffs for fresh vegetables and tender fruits of between 10 and 15%. Although Canadian seasonal tariffs were eliminated, NAFTA includes a snap-back provision to the MFN tariff level until 2008 under certain price and acreage conditions.

Mexican tariffs on a variety of vegetables ranged from 10-15% (10% for fresh products such as bell peppers, cucumbers, squash, snap beans and 15% on processed products such as frozen broccoli and cauliflower and processed potatoes). In general, fresh vegetable tariffs were eliminated immediately and processed vegetable tariffs were phased out over a period ending at the start of 2003.

In addition to market access, other trade barriers included technical barriers, health standards, and marketing regulations. Canadian restrictions on bulk container shipments are an example of these non-tariff barriers. Canadian bulk container restrictions were unaffected by NAFTA (Barichello et al.). Attempts to harmonize health and technical regulations have not been particularly successful. Before NAFTA, Canadian "in season" tariffs on fresh tomatoes were 2.5 cents per pound. Up until 1994, Mexico imposed a tariff of 10 % on fresh tomatoes from the United States.

From 1993 to 2002, Mexican exports of fresh tomatoes to Canada grew at an annual rate of 12% to \$57 million in 2002. Canada did not export fresh tomatoes to Mexico. Although field tomatoes are a seasonal crop in Canada, a vibrant green house industry has also evolved

over the last decade.<sup>2</sup> Canada has had considerable success exporting these tomatoes to the U.S. market. It may be possible that the rapid expansion of the domestic industry has the potential to displace Mexican field tomato imports. However, it appears that field and hothouse tomatoes are differentiated products (USDA-ERS 2000).

Guavas and mangoes are Canada's third largest import from Mexico. The fifth largest import is avocados. These products are not grown in Canada, and there has never been a tariff upon their import. Over the last decade, the annual growth rate of Canadian imports for the category of dates, figs, pineapples, avocados, guavas and mangoes has been 13%, with imports rising to between \$45-55 million over the last three years. In 2001, Canada imported \$30.5 million of guavas and mangoes and \$20.8 million of avocados. Mexico's share of the Canadian market for these products has grown from 30% before the launch of NAFTA, to roughly 40% at the end of the decade.

Prior to NAFTA, the Canadian seasonal tariff on bell peppers was 4.41 cents per kilogram (but not less than 10 percent of the value of the product). Mexico imposed a tariff of 10%. Canadian imports of Mexican pepper grew at annual rate of 13% over the last decade to \$28 million. It does not appear that Mexico has increased its share of the Canadian market relative to other exporters since the signing of NAFTA. Although Canada exports hothouse bell peppers to the U.S. it does not export peppers to Mexico. The growth a domestic hothouse industry may have displace some Mexican imports, but the effect is likely to have only been marginal.

#### Trade in other products

Although only 17% of beer brewed in Mexico is exported, the country is the seventh-largest producer of beer in the world. Canada's single largest agricultural import from Mexico is beer. Imports of Mexican alcoholic beverages have grown significantly since 1994, with an annual growth rate of 11%. Canadian tariffs for whiskies were 7.68¢/liter but beer was duty-free when NAFTA took effect. Mexican tariffs were 16% for beer and 12% for whisky. These tariffs were gradually eliminated by the start of 2003.

Part of the problem of selling alcoholic beverages in Canada is getting access to the distribution system and having products listed in retail outlets. A series of interprovincial trade barriers required beer consumed within a given province to be produced within that province. Some of these barriers were eliminated at the signing of CUSTA. The EU challenged certain practices of the provincial liquor boards that discriminated against foreign alcohol, and in 1993, the US launched a GATT panel case against Canadian beer marketing practices. Canada lost both of these panels and the provincial liquor agencies have become compliant with Canada's

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<sup>2</sup> AAFC (2000) describes the growth in the production of green house tomatoes, cucumbers, lettuce and mushrooms.

international obligations. As such, the opening up of the Canadian liquor market cannot be attributed to NAFTA; other non-NAFTA factors were the cause of the increased trade.

The Canadian brewer Labatt Brewing Company Limited has acquired a 30% interest in Femsa Cerveza. Femsa is the second-largest brewery in Mexico, controlling approximately 39% of that market. However, the popularity of Mexican beer in Canada has also benefited

competitors such as Grupo Modelo (Corona and other brands). Modelo is Mexico's largest brewer with almost 60% of the market. The annual growth rate for Mexican beer imports into Canada was 30% over the last decade with imports equal to \$78 million in 2002. Mexico's share of total Canadian beer imports has steadily grown from 10% in 1993 to 26% in 2002. While NAFTA did not cause the opening of the Canadian market, it did facilitate a stable environment for trade growth. Canadian exports of alcoholic beverages to Mexico in 2001 were only approximately \$1.7 million. However, the projected growth in Mexican consumption should open significant opportunities, particularly in restaurants and hotels.

Coffee is Canada's tenth largest import of a Mexican agri-food product, with a value of \$13 million in 2002. However, imports have remained relatively stable over the last two decades, with variations depending on the quality of the crop. At the time of the implementation of NAFTA Canada's tariff on non-roasted coffee was 4.41¢/kg.

## **SUMMARY AND CONCLUSIONS**

This paper has provided an overview of trade in agri-food products between Canada and Mexico under the North American Free Trade Agreement (NAFTA). A detailed analysis of trade relating to each of the major agri-food sectors was presented and data sources were discussed. It seems clear that NAFTA was an effective trade-liberalization agreement for the two trading partners.

Given the results discovered here, it can be cautiously concluded that trade liberalization under NAFTA resulted in an increased two-way flow of goods between Canada and Mexico. Though the speed at which market access is being granted varies by commodity and to some extent by country, it is clear that NAFTA—perhaps on its own but certainly also as a part of Mexico's trade liberalization strategy—has played an important role in increasing Canada-Mexico trade in agricultural products. Though the effects of trade liberalization have varied by sector, these effects have in general increased bilateral trade flows.



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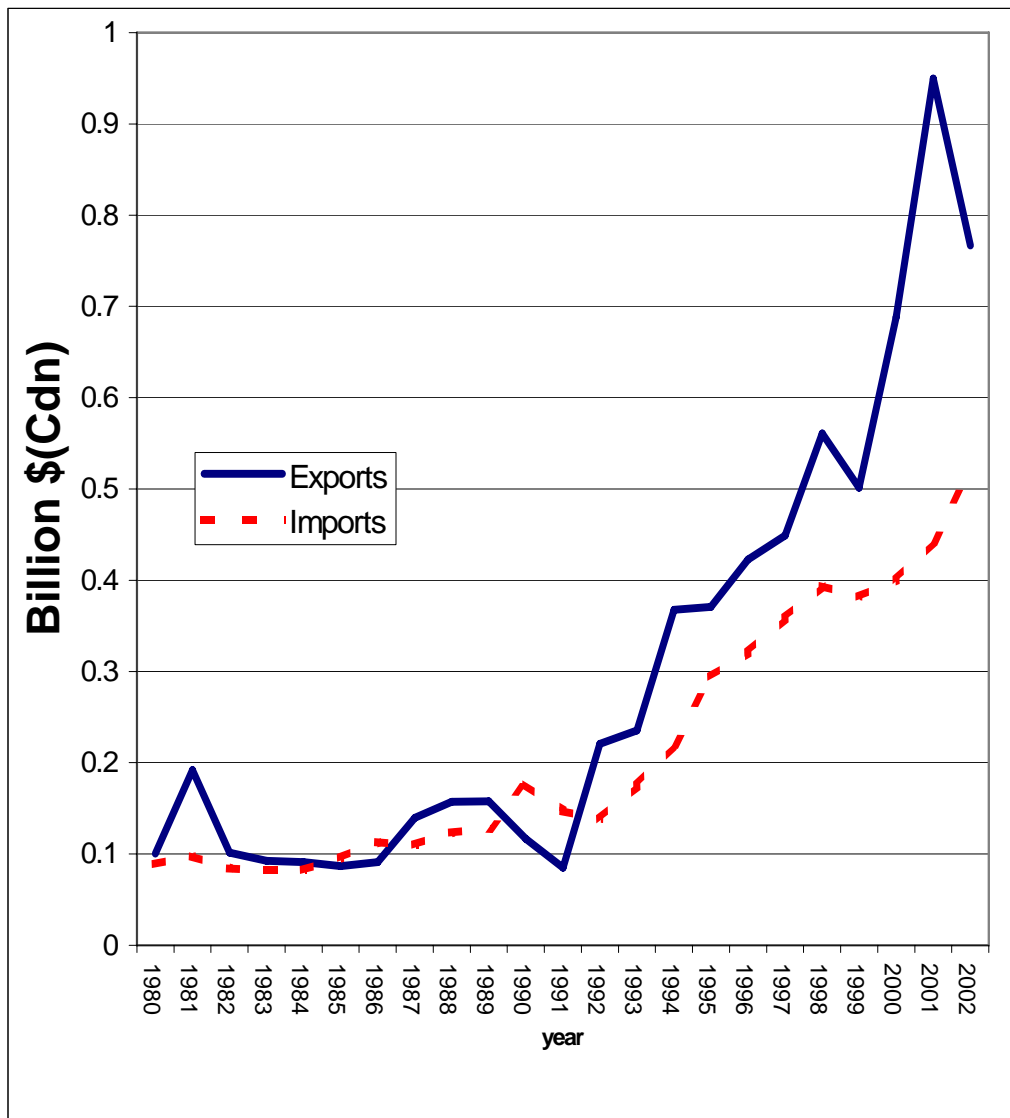
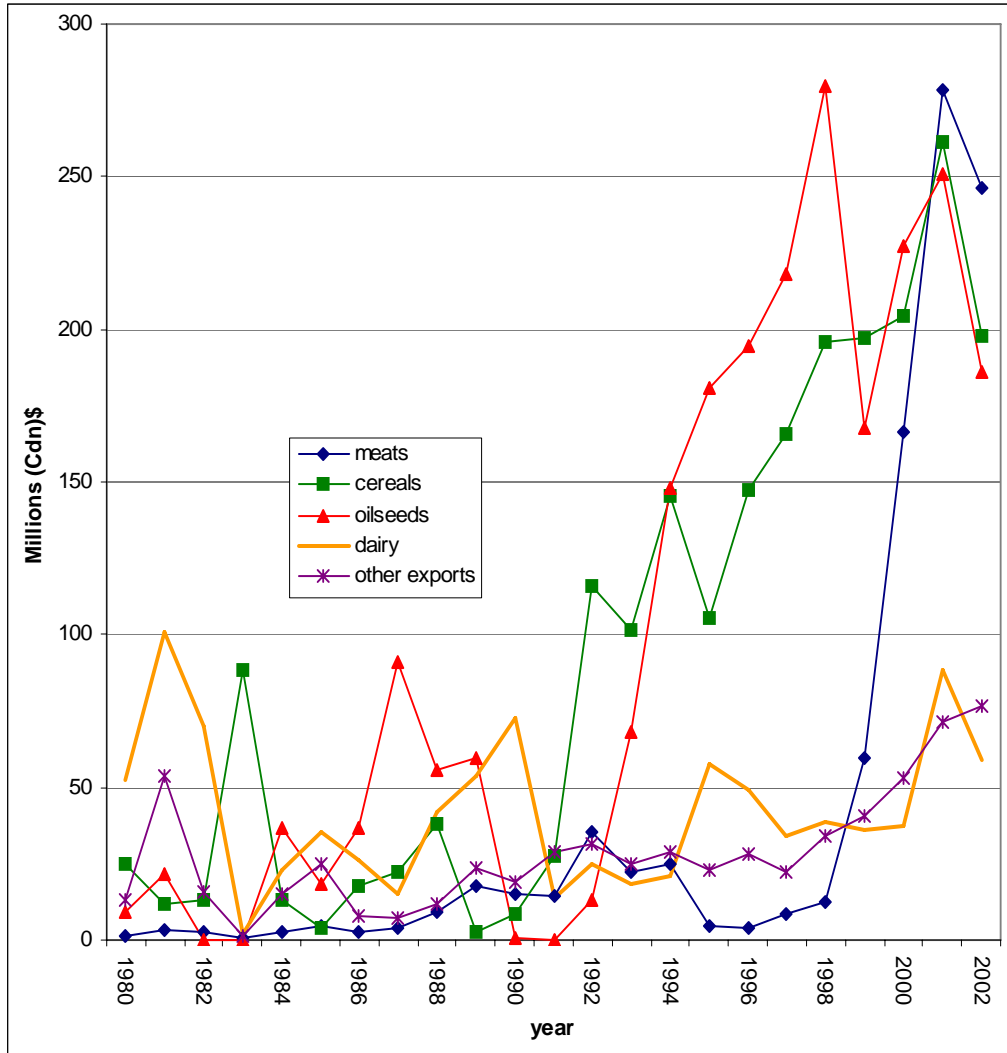
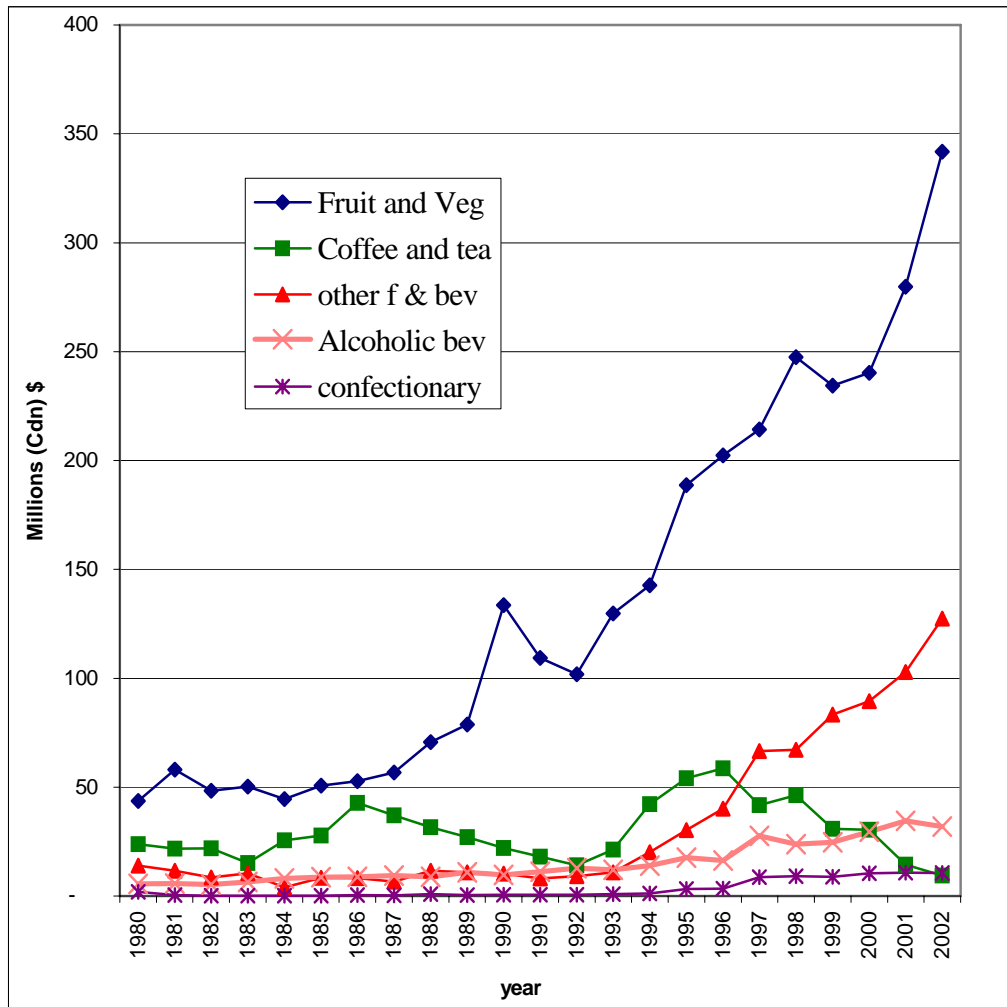


Figure 1. Canada-Mexico Agri-Food Trade, 1971-2002



**Figure 2. Canadian Agri-food Exports to Mexico, Selected Sectors, 1979-2002**



**Figure 3. Canadian Agrifood Imports from Mexico, Selected Sectors, 1979-2002**