Improving the access of Mercosur’s agriculture exports to US: lessons from NAFTA*

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1. Introduction.

In the last 15 years or so Mercosur countries have implemented trade liberalization reforms both unilaterally and at regional level. These reforms have been successful in promoting overall trade flows, but not so much with respect to exports to developed countries. This is particularly the case with the United States (US) and the European Union (EU) markets. For example, in the case of Argentina, exports to the EU have increased only 20% between 1990-2000. Exports to US have grown at higher rates but still below those observed for the rest of the world.

Why is that Mercosur products have been unable to increase their access to these markets? One reason that clearly outstands is that these countries have developed a comparative advantage in agricultural (both primary and manufactured) products and these items have been the ones that faced the strongest protection in the central economies (see Nogues et al 2001).

In this report we will investigate in detail the pattern of agriculture exports of Mercosur countries to US. We will show how the Mercosur region has significantly lost participation in the US import market in the last 13 years mainly as a consequence of the increase in imports from US’s Nafta partners, Canada and Mexico.

In order to understand the reasons behind this phenomenon we first identify those agriculture products for which Mercosur countries have developed strong comparative advantages. In particular we compute the Balassa (1967) indicator of revealed comparative advantage both worldwide and for the US market. This methodology permits to concentrate the analysis on relative few products (10% out of approximately 500 6-digit agriculture items) encompassing almost 90% of agriculture exports of these countries. In addition, the comparison of the indicators calculated worldwide and for US can help us to single out those products for which these countries are worldwide efficient but this is not reflected in the US market.
We then study to what extend this discrepancy is associated with the presence of trade barriers. In particular we give a detailed account of both tariff and non-tariff restrictions affecting these agriculture items in the US. We do find that in some products the presence of these restrictions has been significant. For example, in the cases of Bovine Meat Fresh and Frozen, Chicken and Turkey Cuts, Power Milk, Cheeses and Butter, Citrus (including orange) Juice, Sugar, Peanuts and Tobacco.

The next step in the study is to evaluate the consequences of these barriers on Mercosur countries’ exports and, in particular, to assess the chances they can be eliminated through some type of bilateral negotiations between USA and Mercosur. An ex-ante perspective of the type of deal that Mercosur might strike with US can be obtained from a detailed analysis of what US have negotiated in the NAFTA treaty. Thus an important part of the report is dedicated to the analysis of the NAFTA agricultural provisions. These provisions took the form of separate agreements between US and Canada and US and Mexico.

The description we present of the Nafta agriculture provisions shows that indeed some of the Mercosur key agriculture products were among the most politically sensitive items. In spite of this, Nafta, at least in the case of the Mexico-US Agreement, was successful in assuring free trade in these agriculture items in the long run. The question then arises if the same could happen with Mercosur. There are very important non-economic reasons that have pushed the US government to establish a FTA with Mexico and Canada. Among them the most important is the condition of bordering states and how this influences issues associated to migration, internal security and defense. Clearly these other non-trade reasons are not as important in the case of Mercosur countries and will reduce the impulse of US authorities to pursue such negotiations.

We look at recent US legislation for a more updated inference about the political will of US to pursue further liberalization in agriculture. We concluded that the Fast Truck legislation does impose new restrictions to achieve further liberalization especially within the context of a multilateral and a continental scheme (FTAA). Yet, if anything, it tilts
the remaining possibilities toward less comprehensive (in terms of the involved countries) bilateral or regional free trade agreements in which US exporters can benefit from reciprocal market access gains.

On the other hand, the Farm Bill has produced a change in the design of some sector-specific schemes (i.e. Peanuts) that makes them less inconsistent with trade liberalization. This will increase the possibility that in the future the US government may decide to lower trade barriers for this product. Still on other products, like Milk, a key commodity from the point of view of Mercosur exports, the government support is still oriented at maintaining current prices. We may take the decision of the Congress (of not changing the support scheme for diary) as a signal that further liberalization for this product is not “politically” desired.

The rest of the present report is organized as follow. Next section presents the analysis of the US agriculture import market and Mercosur exports. Section 3 describes the NAFTA agriculture provisions and in section 4 we discuss the lessons this negotiations left for a potential agreement between the US and Mercosur encompassing the agriculture sector. In section 5 we present a summary of our main conclusions.

2. The US agriculture import market and Mercosur exports.

When analyzing the possibilities of a bilateral trade agreement between Mercosur and US and its consequences on agriculture trade, we have to bear in mind that both US and Mercosur countries are very important players in world agriculture markets, reflecting their comparative advantages in the production of these goods. Both regions have been net world suppliers of agriculture goods and for some specific commodities like Soybean, Corn or Wheat, US and Mercosur countries are the most important world exporters (i.e. in the case of Soybeans Argentina, Brazil and US represent together 80% of total world exports).
So it may be the case that there are no many gains to be realized from an agreement that aims at the liberalization of agriculture between these two markets. In order to assess this in this section we will discuss in great detail the structure of agriculture imports of US and the export supply of Mercosur. We will do that at various levels of aggregation and using different types of indicators. We start in the next subsection looking at aggregate trade data.

2.1 The US market for agriculture imports and Mercosur exports: an aggregate analysis.

From the perspective Mercosur exports, how important is the import market for agriculture products in the US? Which are the major suppliers in that market? How the Mercosur exports to US have performed in recent years? In table 1 we present information of the evolution of US agriculture imports, non-agriculture and total imports for the 1989-2001 period. It is clear that agriculture imports are a very small proportion of total US imports. Though they have increased almost 50% in real terms along the considered period, the rate of increase has been lower than that corresponding to non-agriculture products (which rose almost 100% in real terms during the same period). As a consequence, agriculture’s import share has declined over time to reach 3.9% in 2001. Still in terms of its absolute value, and specially when compared to the potential agriculture export of Mercosur countries, US imports of agriculture goods are quite significant: 45 billions dollars in 2001.

Table 2 shows that at the beginning of the nineties the key suppliers of agriculture exports to US were in descending order of importance, the EU, Canada, Mexico, Mercosur, Australia and New Zealand. It is quite remarkable the increasing significance of Canada as exporter of agriculture goods into the US market since 1989 (see Figure 1). US agriculture imports from this country rose 150% (two and half times) in real terms, increasing its share by 10 percentage points (from 13.5 in 1989 to 23.5 in 2001).
It is easy to relate this increase to the CUSTA agreement celebrated between US and Canada, which went into effect in 1989. As we will discuss in detail in section 3, this agreement was quite compressive with respect to agriculture, eliminating border barriers to trade for most products (though there were some conspicuous exceptions), eliminating export subsidies in bilateral trade flows, and imposing more discipline on domestic farm programs. The consequence of establishing a FTA encompassing agriculture’s trade is also reflected in the evolution of US imports from Mexico. The enactment of the NAFTA agreement, from 1994 onwards, is clearly associated with a raise in almost 2 percentage points in the Mexican import share. Measured in real dollars Mexico’s agriculture exports to US almost double between 1989-91 and 1999-01 (84% increment).

We see that this significant increment of the US import share from its neighboring countries came at the expense of some of its third country suppliers. While the EU was able to maintain its participation in the American market, we observed declines for the case of Australia, New Zealand, and most notably, for Mercosur. As shown in table 2 Mercosur share went down from an average of 8% in 1989-91 to 4.5% in 1999-01. This was a direct consequence of the fall in the real value of Mercosur sales to US over the considered period. They were about 2400 millions (2001 dollars) in 1989-1991 and they ended up at an average of 2000 millions in 1999-01 (20% real decline).

Was this fall equal across Mercosur countries? Table 3 shows that the big loser, which explains the entire decline in Mercosur’s participation in US imports, is Brazil. This country was in 1989/90 the Mercosur larger agriculture exporter to US with a value of exports around 1500 millions dollars and a share of about 6% in US agriculture imports (more than three times that of Argentina). In years 2000/01 the value of Brazilian exports went down to 1100 millions dollars, representing less that 2.5 % of total US agriculture imports. In real dollars the fall in exports was around 50% between 1989-91 and 1999-01. On the other hand, both Argentina and Uruguay maintained a more or less constant participation in US purchases of around 1.6 and 0.1 percent respectively.
What explains this bad performance of Mercosur, and of Brazil in particular, in the US market? Could be associated to particular trade barriers faced by these countries (an issue we will discuss in detail in section 2.4)?, or was it originated in shocks affecting agriculture production of these countries worldwide? Figure 2 and 3 (see also Tables 4 and 5) can help us to address this question. In these pictures we present, for Argentina and Brazil, the share of agriculture exports on total exports, calculated both for the world and for the US market. On one hand we see that in both countries the exports to the world are more intensive in agriculture goods than those going to the USA markets. Comparing Argentina and Brazil we see that Argentina’s exports are more concentrated in agriculture (around 42% in 2000/01) than that of Brazil (around 26% in 200/01). This level of concentration has been declining for Argentina in recent years and has remained more or less stable for Brazil (still in both countries we observe relative high values in 1996/97 when international prices were also high).

Perhaps more interestingly is that for both countries we observe a significant decline of the share of US agriculture export over total US exports (the fall is more significant if we compare 2000/01 with 1996/97, but it is also important between the extreme years of the considered period). This decline of the US share is much more significant than that corresponding to exports going to the world. This is specially the case with Brazil.

This drastic change in the composition of export to US suggests that Mercosur countries have met in recent years stronger difficulties to access into that market. Consequently, some exports have to be reoriented to third countries. Clearly, this difficulty may be in part related to the tariff preference that Canada and Mexico have obtained though the FTAs signed with US. In the next subsection, when looking at more disaggregate data, we will try to identify in which products we observe big declines in Mercosur exports to US markets and to what extend those sells were replaced by export from Canada and Mexico.

2.2 Did NAFTA deviate trade from Mercosur origins? A preliminary look using chapter level data.
In order to assess the evolution and composition of US total agricultural imports during the 90’s, we now compare average values corresponding to years 1989-1992, representing a “pre-NAFTA period”, with those average values arising from years 1998-2001, corresponding to a “post-NAFTA period”.

US total agricultural imports averaged almost US$ 26,400 millions during 1989-1992 and US$ 43,600 millions in years 1998-2001, with a difference between both periods of US$ 17,200 millions (see Table 6). In both periods, not only the first six HTS chapters represented near 56% of total, but also these chapters were the same, namely: Beverages (HTS Chapter 22), Edible fruit and nuts (HTS Chapter 08), Coffee, tea and spices (HTS Chapter 09), Meat (HTS Chapter 02), Edible vegetables (HTS Chapter 07) and Preparations of vegetables and fruits (HTS Chapter 20). This suggests that both US total agricultural imports structures (pre-NAFTA and post-NAFTA) were very similar.

Of the indicated increase in US agriculture imports almost 50% correspond to additional export coming from Nafta countries. In this regard US agricultural imports from Canada increased from almost US$ 4,000 millions in 1989-92 to US$ 9,400 millions in 1998-2001, a difference of US$ 5,400 millions, with the share of Canada in US total agricultural imports increasing from 15.1% to 21.5% (see Table 7). In both periods, the first seven groups of agricultural products accounted for almost the same share of total US agricultural imports from Canada, 65% . These are Meat (HTS Chapter 02), Live animals (HTS Chapter 01), Beverages (HTS Chapter 22), Preparations of cereals, flour, starch or milk (HTA Chapter 19), Cereals (HTS Chapter 10), Preparation of vegetable and fruits (HTS Chapter 20), Edible vegetables (HTS Chapter 07).

An interesting finding, is that in six of the seven main groups of agricultural products imported by US from Canada, the share of Canada in US total imports for each group increases between both periods, with the most relevant changes occurred in Meat (from 24.7 to 47.6% of US total imports of this chapter), Preparations of cereals, flour, starch or milk (from 31% to 46.4%) and preparation of vegetables and fruits (from 3.8% to
18%). As we will see in section 3, these tremendous shifts in market shares are clearly associated to the preferential access that CUSTA has created for Canadian supplier of these products compared to those from third countries.

In the case of Mexico, US agricultural imports from this country increased from almost US$ 2,700 millions in 1989-92 to US$ 5,500 millions in 1998-2001, a difference of US$ 2,800 millions, with the share of Mexico in US total agricultural imports increasing from 10.2% to 12.6% (see Table 8). The top three products in 1998-2001, Edible vegetables (HTS Chapter 07), Beverages (HTS Chapter 22) and Edible fruit and nuts (HTS Chapter 08) represented 68% of the total in that period while they were 55% of the total in 1989-1992. These three items together with Coffee, tea and spices; Live animals and Preparation of vegetables and fruits accounted for almost the same share in both periods (88%). As a consequence we conclude that US agricultural imports from Mexico got concentrated in the mentioned first three groups, with decreasing shares in the remaining three chapters (see Table 8). Out of the indicated top six groups of products, Mexico gained share in total imports in Beverages (from 6.5 to 14.6%), Edible fruit ((from 14.3% to 18.3) and preparation of vegetables and fruits (from 7.5 to 10.2%). On the other hand it remained to be the larger supplier of edible vegetables (57.3% of total imports in 1998-01).

Going now to the structure of US agriculture products from Mercosur countries, we observe that US agricultural imports from Argentina increased from almost US$ 500 millions in 1989-92 to US$ 700 millions in 1998-2001, a difference of US$ 200 millions (see Table 9). In spite of this increment in import value, the share of Argentina in US total agricultural imports decreased from 1.9% to 1.6%. In 1989-1992, Preparations of vegetables and fruits (HTS Chapter 20) and Edible preparations of meat (HTS Chapter 16) represented near 58% of total, while in 1998-2001 the first six chapters accounted for almost the same share, with Preparations of vegetables and fruits (18.7%) and Edible preparations of meat (11.3%) being the top ones (Table 9). This fact indicates that US agricultural imports from Argentina diversified in the post-NAFTA years. This is also suggested by the values of the Kreinin and Finger Index (0.66) and the Spearmen
Correlation Coefficient (0.78), indicating that the composition of US agricultural imports from Argentina for years 1998-2001 is somehow different from that corresponding to years 1989-1992.

Regarding the change in participation within total US imports, we observe that Argentina lost a significant share in the US market in the case of Edible preparation of meat, going from 28% to 17%, while it gain participation in oilseeds (from 0.8 to 5.1%) and Cereals (from 2% to 4.3%). On the other hand it remained a very modest supplier of fresh meat (1.1% in 1998-2001).

US agricultural imports from Brazil decreased from almost US$ 1,500 millions in 1989-92 to near US$ 1,200 millions in 1998-2001, a difference of US$ 300 millions, while the share of Brazil in US total agricultural imports decreased from 5.8% to 2.9% (see Table 10). Coffee, tea and spices (HTS Chapter 09), Preparations of vegetables and fruits (HTS Chapter 20) and Tobacco (HTS Chapter 24) represented near 60% of the total US imports in 1989-1992 and 55% in 1998-2001, while almost 90% of total US agricultural imports from Brazil was concentrated in seven HTS Chapters in both periods (Table 10). The fall of imports of Preparations of vegetables and fruits (US$ 200 millions) and of Cocoa and its preparations (US$ 150 millions) explain most of the fall of US agricultural imports from Brazil between 1989-1992 and 1998-2001 (Table 10). In this regard Brazil lost a significant participation in the total US imports of both products. For the case of Preparations of vegetable and fruits the share fell from 18.8% in 1989-92 to 6.3% in 1998-01, while in the case of Cocoa the share went from 16.9 to2.4%.

US agricultural imports from Uruguay increased from almost US$ 40 millions in 1989-92 to near US$ 65 millions in 1998-2001, with the share of Uruguay in US total agricultural imports remaining the same (0.1%) in both periods. In 1989-1992, five HTS Chapters accounted for almost 95% of total US agricultural imports from Uruguay: Edible preparations of meat and Other agricultural goods representing jointly almost 60% of total. In period 1998-2001, Meat and Diary products accounted for near 80% of total US agricultural imports from Uruguay (Table 11). From the comparison in the
change in the structure of imports of US from Uruguay it is interesting to highlight the
tremendous increase of *meat* exports that even surpassed that of Argentina. They went
from 6 millions in 1989-1992 to 41 millions in 1998-01. Still they represented just a
1,3% of total US imports of these products at the end of the considered period.

From the overall analysis of the data at 2-digit level of the HS system we can conclude
that the indicated fall in Mercosur share in total US imports has been caused mainly by a
significant increase of US imports of some agriculture products from its Nafta’s partners.
This is the case, for example, with Meat (1000 million dollars raise in imports from
Canada), Edible Vegetables (850 million dollar increase in imports from Mexico);
Preparation of Cereals and Flour (600 millions raise from Canada), Preparation of
Vegetables and Fruit (400 millions from Canada and 100 millions from Mexico). To a
lesser extend the fall in Mercosur participation has also been caused by a decline in the
value of Mercosur’s exports of some commodities. This has been particularly important
in the case of Brazil with preparation of vegetables and fruit where Brazilian exports fell
more than 200 millions and *Cocoa and its preparation* with a fall of about 150 million
dollars.

How much of this change in the geographical composition US imports can be attributed
to a process of pure trade creation originated within Nafta as a consequence of the fall of
tariff barriers? To what extend does this change also reflects, at least in part, a process
were trade flows has been diverted from Mercosur origins? We cannot give an
appropriate answer to these questions just looking at trade flow data. This is because
along the considered period not only have trade barriers changed but also other
determinants of import demand like income.

An important piece of information that is required to address this issue of trade creation
vs trade diversion is import prices. In a very simple partial equilibrium framework, trade
creation takes place when we observe a decline in import prices following the reduction
in trade barriers (so total imports raise). An additional condition is that imports from third
origins are zero after the change in tariffs. In this same framework, if after the reduction
in domestic barriers there are still imports from third country origins then import prices
would not fall (as a consequence of the FTA) and the reduction in trade barriers is
associated with pure trade diversion. Moreover, if in this equilibrium we allow for
imports to change (increase) due to an increase in national income, the additional imports
will come from the rest of the world.

We didn’t pursue the price analysis so we are not able to apply the above framework to
investigate whether trade diversion out of Mercosur countries has been important. The
relevant theory predicts a fall in the import shares of Mercosur both if trade creation and
trade diversion occurs. Still, as indicted, in case of trade creation no imports from third
markets are observed in equilibrium. The fact that this is not what have occurred suggests
that for the case of some products, like preparation of fruit and vegetables, meat and
preparation of edible meat, Mercosur countries may have suffered a significant process of
export losses due to trade diversion.

Thus a process of trade liberalization of agriculture between Mercosur and US can
revert some of these negative consequence of Nafta and, moreover, it could give rise to
additional gains from trade creation. But what products or sectors could be the ones that
have the most to gain from this hypothetical FTA between US and Mercosur? To answer
this question we have to look not only at existing Mercosur export to the US (which
could be affected by existing barriers in that market), but try to identify, using world
market data, where the comparative advantages of these countries lie. We do this in the
next section.

2.3 Mercosur comparative advantage in agriculture exports and their access to the
USA market.
In this subsection we will investigate in more detail what are the agriculture products that Mercosur countries are more efficient at producing, working at very disaggregate level. In particular, following Balassa (1967), we are going to calculate various indicators of revealed comparative advantages (IRCA) using 6-digit HS data on trade flows for years 1998-2000. The Balassa indicator takes the following form,

$$IRCA = \frac{\frac{x_{ij}}{X_j}}{\frac{X_i}{X}}$$

where $x_{ij}$ are the exports of product $j$ by country $i$, $X_j$ are total exports of product $j$ for the considered sample of countries, $X_i$ are total exports of country $i$, while $X$ is total export for the considered sample of countries. The above index takes values between 0 (when a country does not export product $j$), and potentially large positive numbers (when, for example country $i$ is the only world exporter of product $j$, but at the same time has a very tiny participation in total world exports). When the IRCA indicator has a value greater than one we say that country $i$ has a revealed comparative advantage in product $j$ relative to the considered sample of countries.

We will compute the IRCA indexes worldwide and also in terms of the USA import market. The finding of large differences between the two indexes (for example, a product for which a given country is very competitive worldwide but not in the US) may suggest the presence of market access problems. Latter on, we will investigate whether this disparity between the two indicators can be associated to the presence of specific trade barriers.

Tables 12-14 present the result of the IRCA calculations for Argentina, Brazil and Uruguay, respectively. Each table is organized as a double-entry spreadsheet where in the horizontal direction we indicate the number of tariff lines and export volume corresponding to 6-digit agricultural products for which the IRCA-world is greater (first row) or lower than one (second row). On the vertical dimension we indicate the tariff
lines and trade volume associated with the IRCA calculated for the US market, distinguishing again between those products where the indicator is greater than one (left) from those where the indicator is lower than one (right). There is a third column (and row) where we indicate the total number of tariffs and of exports.

Table 12 shows that Argentina has worldwide comparative advantages in 72 6-digit HS products which represented an annual value of export of 10.196 millions dollars during the 1998-2000 period. Notice that the IRCA indicator is a good predictor of Argentina’s comparative advantages in agriculture. These 72 products represent only a 13% of the total of 569 agriculture tariff positions for which we observed positive export during this period, but at the same time they capture a vast majority, 88%, of the total agriculture exports.

Argentina has a revealed comparative advantage in the US market in 64 tariff lines, representing exports to US for about 662 millions per year in 1998-2000 (93 % of the total US exports). Now as indicated above we are interested in one particular intersection of these two comparative advantage indicators. This is where IRCA-world is higher than one and IRCA-USA is less than 1. That is, we want to identify those products where Argentina has gained a significant presence worldwide, but this is not reflected in the US market. As we see, this occurs in 35 positions (6% of the total 6-digit HS products). Total exports to US of these products were only 1 million dollars per year in 1998-2000, while they were around 6442 millions dollars to the world. So it is clear that the low level of export to US was not associated to export supply deficiencies. The possibility that this discrepancy can be explained by the presence of trade barriers is explored in the next subsection.

We may also be interested in highlight another type of intersection between the two IRCA indexes. That in which Argentina is not worldwide efficient (IRCA world less than 1), but for some reasons it has gained significant access to the US market (IRCA US greater than 1). As we see this case encompasses a total of 27 tariff positions with a value of exports to US of around 101 millions (14% of total US exports), while world exports
of these products have been 231 millions (2% of total world exports). There could be many reasons explaining this other discrepancy between the two IRCA indexes, but one aspect that is relevant, from a perspective of trade policy, is the possible presence of same type of preference Argentine products may enjoy entering the US market compared to other countries (for example, the Generalized System of Preferences applied by US to developing countries). The practical relevance of this issue will be also subject of analysis in the next subsection.

When we apply the same type of analysis to the case of Brazil (see Table 13) we find similar results to that of Argentina. That is, Brazil’s worldwide comparative advantage in agriculture products is concentrate on few items (59 tariff lines, encompassing 10% of the 579 lines with positive exports in 1998-2000), which all together represented 12665 millions dollars of average annual exports (90% of total world exports) in 1998-2000. On the other hand, Brazil has developed comparative advantages in the US market in 53 products, which represented 93% of the total exports to US (1216 millions dollars). Out of the 59 products for which IRCA-World is higher than 1, we see that 32 of them have not been successful in entering the US market (IRCA-USA less than 1). This is clearly demonstrated by the fact that export to US of these 32 item averaged only 8 millions per year in 1998-2000, while export to the world of the same products reached 5848 millions per year during the same period.

The analysis for Uruguay is presented in Table 14. This country has 57 tariff lines (18%) for which IRCA-world is greater than one encompassing 1054 millions of exports (93% of total agriculture exports). Out this 57 positions 33 correspond to 6-digit products where the IRCA-USA is lower than one. The apparent difficulty that Uruguay has faced in selling this goods in US is reflected in the fact that export through these positions have been only 0.1 million dollars per year in 1998-2000 while at the rest of the world Uruguay has exported around 584 millions through the same tariff lines.

Finally, it could be interesting to do the same analysis for Canada and Mexico. We would expect that, given these countries’ preferential access to the US market, the
comparative advantage indicators to the world and US would not differ much. This is precisely what is suggested by the information presented in Tables 15 and 16. For example, for the case of Canada, out of the 154 tariff lines where IRCA world is higher than one, for only 18 (12%) the comparative advantage indicator for USA is below 1. We can also investigate whether we have many items where even though Canada is not world-wide efficient (IRCA world less than one), the preferences obtained in the US market (including transport cost savings) has facilitated the introduction of these goods. In this regard Table 15 shows that out of the 277 products where IRCA-USA is higher than 1, in approximately 50% of them the IRCA world is less than one. Nevertheless, notice that through these positions goes a small proportion of exports to US (10%), the rest corresponds to products that Canada has also reached world-wide comparatives advantages.

What are the agriculture products in which Mercosur countries have developed comparative advantages? This information is presented in Tables 17-19. Table 17 shows the data for Argentina. Out of the 72 products for which we found this country has a worldwide comparative advantage, the table lists those for which world export have been higher than 10 millions per year in 1998-2000. Besides export to world markets, the table also shows the value of export to US and the corresponding levels of the IRCA indexes. Within these 49 items, we have highlighted (in italic and black) those product that have an IRCA-US index less than one and also (in black) those where IRCA world is higher than that of IRCA USA though this latter it is also higher than one (reflecting a relative larger insertion in world markets compared to US).

As we see, Argentina has developed strong worldwide comparative advantages in the production and exports of various oils (and their solid residuals) produced out of sunflower-seed, soybean-seed and peanuts. Of course, the direct exportation of the seeds out of which these oils are produced has also been important but in general we observe a lower level of the comparative advantage indicator for the unprocessed input. Other products for which Argentina has a significant worldwide comparative advantage and where the volume of export is very significant are corn and wheat. With low level of
world exports but still with large values for the IRCA index we have citrus juice, grape juice and apple juice as well as apples and lemons and olives. Finally with a less significant comparative advantage parameter (but still with greater than 1) we find power milk and fresh and frozen bovine meat cuts.

Within the products where Argentina is worldwide efficient but has not been relatively efficient at penetrating the US market, we have to highlight for their sharp contrast between world market exports and those going to US the cases of crude oil soybean (1185 millions to world and zero to US), solid residuals from extraction of soybean oil (1904 millions and zero), corn (1000 millions to almost zero) and wheat (1170 millions and zero). Though in the next section we will investigate in detail the presence of trade barrier for these products, it is clear that such contrast between worldwide export supply and US import from Argentina is largely explained by the fact that US is also a major producer and exporter of these goods. Thus, US imports of these goods are very low or zero from most countries.

This is not the case of other agriculture items like olives and olive oil, power milk, fresh bovine meat, onions sets, wool, malt, fresh plums and prunes. These products represent items where Argentina, being worldwide efficient, have met difficulties in accessing the USA market. We have few other products where though the IRCA USA is close or even larger than one, the difference with the IRCA world is very significant suggesting that Argentina could potentially have a much significant presence in the US market. These are the cases of Sunflower-seeds and Sunflower oil.

Table 18 shows the list of the products in which Brazil has develop worldwide comparative advantages and for which there were exports to world markets equal or greater than 10 millions per year in 1998-2000. These are 37 products out of the 59 for which we have found that IRCA world was higher than 1. As we did for the case of Argentina we have highlighted in italic and black those items where the IRCA-US was lower than one suggesting problems in accessing the US market and in black those where IRCA world is higher than that of IRCA USA though this latter it is also higher than one.
As we see Brazil has developed strong comparative advantages, which have rendered significant values of world exports, in products like Orange juice (1172 millions dollars of world exports), raw and refined cane sugar (1600 millions), Frozen Chickens cut and uncut (800 millions), Coffee (2000 millions), Soybean (1986 millions), Crude Soybean oil and their residuals (2100 millions).

Within the products that Brazil has worldwide comparative advantages and have not been successful in penetrating the US markets we find, as in the case of Argentina, a large disparities in products where US is also one of the top world exporter. This is the case with Soybean seeds and Soybean oils and its residuals. Other products where Brazil faced strong difficulties to penetrate the US market and there is no presumption that US is a significant worldwide net exporter are Raw and Refine Cane Sugar, Frozen Chicken (cut and uncut), Frozen Bovine Meat Cuts, Tobacco, Cuts of Turkey, Melons and Papayas. With regard to Orange Juice though Brazil has been relative successful in exporting to the US (the IRCA-US is greater than 1), the significant difference between export to US and that to world markets (almost 10 times higher) may imply that greater participation in US is still possible.

Table 19 describes the list of products for which Uruguay has developed world-wide comparative advantages and where exports have been at least 1 million dollars per year during 1999-2001. These are 45 items out of the original 57 positions. We see that Uruguay have met difficulties to enter the US market in some of its key agriculture commodities (italic and negrita items). This is the case of, for example, Rice Products (204 millions of export to the world and zero to US), Milk and Cream products (85 millions and zero); Bovine meat cuts fresh and frozen (254 millions and 27 millions); Mandarins, Oranges and Lemons (46 millions and zero).

In the case of other dairy goods like Butter and Cheeses, Uruguay has developed a strong export performance in world markets (59 millions of exports), which is much less reflected in the US (4 millions of export). Still the IRCA USA indicator is higher than
one because, as we will see below, of the strong inward orientation of this sector in the US economy.

The use of the Balassa indicators has helped us to identify where the comparative advantages of Mercosur countries lay in terms of agriculture products. It has also helped to single out those products for which world-wide efficiency was not reflected in the US market. The next step is to study whether these discrepancies are or not associated to the presence of tariff and non-tariff barriers. We do this in the next subsection.

**2.4 Tariff and non-tariff trade barriers affecting Mercosur agriculture export in US.**

In what follows we present a detailed analysis of the various tariff and non-tariff barriers affecting Mercosur key agriculture exports in the US. Though we still keep our product aggregation assumption at the 6 digit level of the HS system, in each case we will indicate the number of 8 digit positions that are affected by a given measure. For each country we present two tables: one with a description of tariff barriers and a second with the detail of non tariff measures. The information on tariffs and non tariff barriers was obtained from the US HTS, from CNCE (2001) and from Funcex (2001).

In the tables corresponding to tariff measures (see Tables 20, 22 and 24) we present three different tariff indicators. First an estimation of the implicit average tariff corresponding to the 6-digit agriculture aggregate. This is obtained by dividing the amount of duties collected over imports from each country at the 6-digit commodity definition. This a rather rough measure of average tariff protection; still we decide to include it because it provides a first estimation of the equivalent Ad-valorem protection in case of products that are subject to specific duties. Of course as we will see below this indicator is not very informative in cases where there is no imports and also it will tend to underestimate the average protection of a determinate 6-digit aggregate when, as a consequence of high specific tariffs, some of its 8-digit products are not imported.
In the tariff tables we also report the actual Ad-valorem tariff applied to each product indicating the minimum and maximum duties within the corresponding eight digit items. Finally we indicate the number of 8-digit lines subject to specific duties, showing also the minimum and maximum values. In this case, though, a higher absolute value of the specific tariff is no indicative of a higher rate of protection; to evaluate this we have to have information on the product price. Below we present ad-valorem equivalences for specific duties applied to some 8-digit items.

The information about non-tariff barriers (see Tables 21, 23 and 25) is organized following the OECD methodology for the classification and measurement of NTBs (see OECD (1999)). Thus in the Tables we only describe the "Core NTBs" defined as those affecting imports quantities and prices directly. These are: non-automatic import licenses, tariff rate quotas, seasonal tariffs, special agriculture safeguard actions (introduced within the Agriculture Agreement of the UR) and antidumping and compensatory measures. In each case we present the number of 8 digit items affected by these restrictions. One additional restriction affecting agriculture commodities, which we may be letting aside, is that of phytosanitary standards. Yet we have to bear in mind that these requirements are many times implemented through non automatic licenses, so the extend to which this is an important restriction will be partially captured by the coverage of this licensing measure.

Starting we the tariff structure applied to Argentina’s exports (see Table 20) we observe that most of the six digit aggregates include 8-digit items that are subject to specific tariffs. This makes less transparent the degree of protection applied to the involved products and, perhaps more important, raises the implicit rate of protection in times of low international prices. Overall, the implicit average tariff calculations seem to suggest that at the six digit level, the degree of protection faced by Argentine products are not significantly high, with the possible exception of Citrus Juice where the implicit duty is 37.7%. Still this conclusion is not entirely confirmed when we analyze tariffs encounter at a more disaggregate level. For example, in the case of Bovine Meats Cuts, Boneless, Fresh or Child, a product that Argentina has faced difficulties to sell in the US market,
there are 5 items that are subject to ad-valorem tariff, some of which are as high as 26.4%. The two other 8-digit products are subject to specific tariff of 0.044 US$ per kilo; these are not very high tariff when evaluated at current prices (implying an ad-valorem tariff of 0.6% and 1.4%). Still, when we look at the non-tariff barriers applied to these items we find that all positions are subject to Non Automatic Import License (originated in sanitary restrictions), three are affected by Tariff Quotas and one is subject a Special Agriculture Safeguard Provision.

Another example is Power Milk. This is also a product that is very high in the list of Argentine priorities in the US market. The implied average tariff seems to suggest a very small level of protection (1.9%). Nevertheless, this is a result of a noisy estimation given the very low level of US imports (just 40 thousand dollars). As we see, all 8-digit products here are subject to specific tariff varying from 3 cents to 1.56 dollars per kilo. We have calculated that for some positions (i.e. 04022125) these tariffs are as high as 49.1%. These products face in addition Non-Automatic Import Licenses (6 out of 9), Tariff Quotas (3 items) and Special Agriculture Safeguard Provisions (3 items).

If high protection both by tariff and especially non tariff barriers is an indication of a US import sensitive product, within the ones that are important for Argentina, we have, beyond the two indicated above, the case of Peanuts. This is a product that in principle Argentina has been able to introduce in the US market (exports to USA were 40 millions per year in 1998-2000 while they were 200 millions to the world), but this was thanks to a quota system that allowed to export certain quantities at a specific tariff of 0.066 cents by kilo. As we see in Table 20 the tariff applied for import outside these quota quantities could be as high as 131%. Besides tariff rate quotas, imports of Peanuts are subject to special safeguard provisions. Honey is another product that Argentine producers have been able to successfully introduce in the US market but recently they have face antidumping and compensatory actions from US Government.

The difficulty of Argentine Olive producers to enter the US market seem not to be associated to high specific tariffs (their implied ad-valorem rates varies between 0.5%
and 1.2%), but to the presence of licensing requirements (affecting almost all 8 digit items) and tariff rate quotas (applied to 25% of the tariff lines). Lemons, Onions Sets and Plums face specific tariff that vary between 3% for lemons, and 1% and 5% for onions, and also non-automatic license requirements. This is not the case of Apples that face zero tariffs and the only impediment to export to the US markets is licensing.

Finally, as suspected, grains like Corn, Sunflower and Soybeans, as well as oil and other products made out of Soybeans, face very low border protection in US. Thus the apparent difficulties of Argentine exporters are due to the fact that, as indicated, US is a major producer and exporter of these products.

Going to the case of Brazil (see Tables 22 and 23), in addition to Bovine Meat, which faces the same barriers as Argentina, Frozen Cuts of Chickens and Turkey have also met market access problems. Brazil is a key world exporter of these products and has not been able to sell a single ton in the US. The difficulty seems to be associated with specific duties (which tariff equivalent rates could be as high as 23%) and also the presence of licensing requirements, originated in sanitary standards. A second key product where Brazilian exporters have faced severe restrictions is Sugar. Imports of Sugar are subject to very high specific tariffs for which ad-valorem equivalent rates reach up to 118% (i.e position 17011150). Sugar is also subject to tariff rate quotas, where the high tariff indicated above is applied for off-quota quantities. Thus exports outside the established limit are practically prohibited.

Orange juice producers of Brazil have been able to enter the US markets even though on average they have paid high duties. As shown in Table 22 the implicit average tariff has been around 43% (taking the average product price of 1998-2000), this value being the tariff equivalence of a specific duty of about 0.079 US$ per liter. No other restriction beyond licensing affects imports of this product.

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1 The US has required that Brazil exports of chicken be free of the “New Castle Disease.”
Tobacco products also face high tariffs and non-tariff restriction affecting Brazilian exports. For example for some 8-digit tariff lines the tariff reaches 350%. This is combined with the establishment of tariff rate quotas. On the other hand, Fresh Melons are subject to high tariffs (for some products they reach 29.8%) and licensing requirements.

Within the products that Brazil is a key world exporter and face very low border barriers within US we have Soybeans and Seeds of Forage Plants. This list also includes Soybean Oil, which is subject to an ad-valorem tariff rate of 19%. Brazil difficulties to enter into the US market in these cases (as it also happens with Argentina) are then associated to US strong production and export position in these products.

In the case of Uruguay (see Tables 24 and 25) we also find that the presence of tariff and non-tariff barriers in the US market explains in part the difficulties of market access of products in which Uruguay is world-wide efficient. This is the case of Bovine Meat Cuts and Milk Power, products that face the same barriers as those faced by Argentina’s exports. There are other diary items that Uruguay has been able to export world wide like Butter and Cheeses and which face very strong tariff and non-tariff barriers in US. In the case of Butter the implicit average tariff calculation suggest that on average Uruguay exports pay a duty of around 46% (see Table 24). Cheeses pay specific tariffs that are equivalent to rates going from 38% to 67%. In addition, these diary items are subject to import licensing, tariff rate quotas and special agriculture safeguard provisions.

Uruguay has also been comparatively less successful in exporting to US citrus like Oranges, Mandarins and Lemons. Nevertheless in this cases border protection in the form of specific tariffs are not to blame; the equivalent rate for these commodities are quite low (2% for oranges and 1.3% for mandarins), though the presence of licensing requirements may have affected the introduction of these products in the US market. On the other hand, as in the case of Argentina, Uruguay exports of Juice made out of citrus fruit did face strong border protection in the form of specific duties equivalent to a 37.8% ad-valorem tariff rate.
From the above evidence about tariff and non tariff barriers, we can conclude that the divergence found for some products between the IRCA indicators is in part a consequence of the presence of border barriers in the United States economy. Within this list of key Mercosur products, the ones that face the strongest barriers are Bovine Meat Fresh and Frozen, Chicken and Turkey Cuts, Power Milk, Cheeses and Butter, Citrus (including orange) Juice, Sugar, Peanuts and Tobacco.

What could be the consequence on Mercosur exports of a complete elimination of these trade barriers? There is not an easy answer to this question and it is not the purpose of this report to develop these estimates. The results will greatly depend on the assumptions regarding the negotiation context in which such tariff reduction are made (multilateral, regional or bilateral) and also the type of model we use to isolate the effect of the tariff elimination. For the case of Argentina exports to US, there are already available estimations using a partial equilibrium framework (see CNCE (1999)) and also general equilibrium computable models (GECM) (see Fundacion Mediterranea (2000)). Both types of estimations predict sensible increments of export for some products (for example, the GECM model predicts a 60% raise in sugar exports, 20% raise in dairy, 11% raise in vegetables and fruits). Still, both methodologies tend to underestimates the resulting increases in exports. This is because these projections are made based upon historical levels, which as we saw are quite low in cases of products subject to significant trade barriers. So to apply the predicted percentage increase in exports upon that very small initial value tend to drastically underestimate the effect trade liberalization.

An alternative way to evaluate the extent to which Mercosur exports would raise is to look at the NAFTA experience for similar products. Of course, the experience of NAFTA cannot be mechanically translated to Mercosur even if we assume that the same level of tariff reduction (that is, total liberalization) can be achieved (this point is discussed in detail in section 3.3 below). This is because the fact that both Mexico and Canada are border economies permits great saving not only in terms of direct transport costs but also in other general transaction outlays. There are many studies that have calculate the effect
of transport cost on trade and the special character that a border economy plays in its
dynamics (see, for example, Engel and Roger for USA-Canada and Garriga and
Sanguinetti (1994) for Argentina-Brazil).

Thus we cannot expect that an eventual US-Mercosur agreement would generate
increments in Mercosur exports anywhere near those we observed for Mexico and
Canada. Still, even if we assume that trade creation will be of much smaller magnitude,
the resulting value for some of the above commodities could still be very significant. For
example, if we were to assume that complete elimination of bovine meat trade barriers
could generate an increase in US import of meat from Mercosur equivalent to 10% of that
observed from Canada, that would imply approximately an additional one hundred
millions dollars in exports from Mercosur origins.


Agriculture has always been a very sensitive sector in international trade negotiations.
At the multilateral level, the GATT from its beginning has treated agriculture differently
from most other sectors, allowing for the use of quantitative restrictions and other type of
trade-distorting subsidies. It was only recently, in the Uruguay Round (UR) held between
1986-1994, that agriculture was first included on a similar basis as other sectors. The
main result of the negotiations, tarification of non-tariff restrictions, reduction in tariffs,
and discipline of trade-distorting domestic and export subsidies, can be considered a first
initial step toward global free trade in agriculture. Still we are far away from obtaining in
this sector trade conditions anything similar to those actually in practice in the non-
agriculture products.

Did regionalism perform better in terms of liberalizing agriculture? And how this
preferential agreement affected welfare of the involved countries as well as world-wide
welfare? Agricultural liberalization within regional agreements was in the past (say up to
1980), similarly with multilateralism, very limited with the possible one exception of the
European Economic Cooperation Agreement (1957). In contrast most RTA formed in the
last ten to fifteen years included agriculture in the removal of internal trade barriers. The degree of inclusion and the deepness of liberalization they reached in each case vary significantly (see Sheffield (1998)). Still we can fairly say that most of them go beyond what has been reached in the multilateral arena. For example, the Closer Economic Relation Agreement (CER) signed between Australia and New Zealand in 1983 reached free trade in agriculture; in the western hemisphere, the CUSTA agreement between US and Canada signed in 1989 also eliminated tariff in most agriculture products (more on this below); similarly the Mercosur accord, signed between Argentina, Brazil, Paraguay and Uruguay, has removed all tariff and non tariff trade barriers between members with the exception of sugar.

The question regarding how these regional agreements have affected worldwide welfare can be decomposed in two issues. First, we have the more narrow assessment regarding whether this preferential agreement has caused a strong inward bias in trade flows in agriculture, that is, if they have significantly deviated trade from the rest of the world. Second whether these agreements have been “stumbling blocs” in the path toward worldwide free trade in agriculture.

Regarding the first point the evidence shows (see Vollrath (1998)) that with the notable exception of the EU, none of the most relevant regional trade agreements (i.e. CER, CUSTA, MERCOSUR) diverted agricultural trade at the sectoral level. With respect to the second point, most countries belonging to these agreements have had a strong activity within GATT for more open trade in agriculture (see for example the CAIRN group encompassing CUSTA, MERCOSUR and CER countries). Again, the major exception has been the EU. It is widely recognized (see Sheffied 1998) that the creation of the EEC in 1957 proved to be a main impediment to greater agriculture liberalization in the Dillon (1961-62) and Kennedy (1964-67) rounds. This situation repeated itself in the more recent UR, which almost collapsed at the beginning of the 1990 because of the strong opposition of the EU to make higher commitments regarding agriculture. Indeed, the proliferation of FTA that we observed in the nineties was in part a response to the perception of a weak multilateral instance.
In the next section we will analyze to what extent the NAFTA agreement implemented in 1994 has gone further, compared to UR compromises, in liberalizing agriculture.

3.1 NAFTA provision for agriculture.

In May 1990, and in a context where UR negotiations were stalled, Mexico proposed the US to negotiate a FTA. The negotiations were expanded to include Canada in 1991. An initial trilateral agreement was reached in August 1992 and signed by the three Presidents in December. With the coming of President Clinton to the US administration in early 1993 new supplementary side agreements were negotiated in order to clarify and strengthen the initial provision of NAFTA with respect to environmental protection, labor rights and a mechanism to protect domestic producers from unanticipated, sudden surge in imports. Congress finally approved these side agreements and the implementing legislation in November 1993 and the NAFTA came into effect in January 1994.

Regarding agriculture, the NAFTA accord is composed basically of three bilateral agreements among US, Canada and Mexico. It incorporates the Canadian-US free trade agreement (CUSTA) implemented in January 1989 and adds bilateral accords between United States and Mexico, and Canada and Mexico. NAFTA’s treatment of agriculture is comprehensive and, with few exceptions, provides for the eventual full liberalization of agricultural trade in the region. In addition to tariff and quotas, NAFTA addressed export subsidies, import safeguards, rules of origin, and sanitary and phytosanitary (SPS) requirements.

Market access

Between the United States and Canada, tariff on most agriculture products were phased out over a 10-year period, and were completely eliminated by January 1, 1998. Still there were exceptions to bilateral free trade. In particular, as already agreed under the CUSTA, NAFTA allows Canada to maintain permanent restrictions on imports of dairy, poultry and eggs from the United States, while US maintained restrictions on imports of sugar,
dairy and peanuts from Canada. These restrictions, originally specified as quotas, were later redefined as tariff-quotas (TRQs) to comply with WTO rules.

The bilateral agreement liberalizing agriculture trade between United States and Mexico left no commodity out of the process of tariff and non-tariff barrier elimination. A key ingredient in this result was the early decision taken by the Mexican authorities to include its politically sensitive corn sector, leaving little room for other exclusions (Orden (1996)). The bilateral agreement called for the elimination or phase out of existing tariffs. For 56% of pre-Nafta trade, tariffs were eliminated immediately or have a phase-out period of five years. An additional 23% of the pre Nafta trade was subject to longer adjustment periods between 5 and 15 years.

Regarding existing quotas licenses and other quantity restrictions, NAFTA stipulated that all of them should be converted into tariff rate quotas (TRQ’s). For imports above the TRQs, over-quota tariffs were set to provide initial protection equivalent to the previous non-tariff measures. The over-quota tariffs were completely phased out over adjustment periods of 10 or, in some cases 15 years. Over 21% of the pre-NAFTA trade was subject to this type of mechanism. It is clear that sectors receiving this treatment were among the most sensitive for both countries and in the short and medium term the level of liberalization agreed upon was not significant. Market access under the TRQ’s was based upon trade levels observed in 1989-91 and were scheduled to increase only at a 3% percent annually. Initially this was the only way to increase export of these goods to the pattern country as the over quota tariffs were quite high: in the case of Mexico over-quota rates were 215% for corn and 260% for chicken. For US, cheese faced an over-quota rate of 70% while it was 125% for peanuts.

Another sensitive sector that received a special adjustment mechanism during the transition to free trade was sugar. First, the TRQ was fixed at 25000 metric tons during the first 7 years of the agreement. After the seventh year Mexico will gain market access to the US market only if it became a “surplus sugar country” based on the difference between production and consumption, with unlimited access to its surplus if it became a
surplus regions for two consecutive year. Meanwhile, the US TRQ tariff for sugar was going to be reduced over a 15-year period.

Frozen concentrated orange juice was also a sensitive product. Though before NAFTA it was subject only to tariff barriers, the negotiators agree to establish a TRQ. The within quota tariff was set at half of the MFN level. The over-quota tariff was set initially at the MFN level and then reduced 15% over a six year period, then stayed constant for four years, and finally it was going to be phased out over the remaining five years.

A special mechanism was also established for horticultural products. This consisted of a safeguard provision for seasonal imports entering the US market. These products (i.e. tomatoes, peppers, onions, etc) were to have a TRQ with a 10-years lapse of adjustment but the over quota tariff were held at MNF level during the whole period and then eliminated in one step at the end.

Finally there was an emergency action provision that was going to be applied for any agriculture good during the transition. Under this provision a scheduled tariff reduction was going to be suspended and the MNF tariff reestablish for up to 4 years if imports have become or threaten to become a substantial cause of injury to a domestic industry. This emergency action was limited to a single application for any commodity.

In the Canada-Mexico agreement, Canada accorded Mexico the same treatment as the United States under CUSTA. Thus Canada continued to establish import restrictions on dairy, poultry and eggs. Mexico specified long-phased out periods for the same commodities as agreed upon in the Mexico -US Agreement. As a reciprocal measure on the permanent measures of protection imposed by Canada, Mexico retained its import protection for those goods that in Canada were subject to supply-managed programs: poultry, dairy and eggs

**Domestic support and export subsidies**
The NAFTA agreement imposes no direct restriction on the domestic support programs each member country applies to its agriculture sector, though it emphasizes countries should respect and comply with compromises taken in this area at the multilateral level (GATT). In spite of this “free hand” approach, domestic support programs have been subject to significant changes in the NAFTA countries since 1994 (see Burfisher et al (1998)). In general, domestic reforms implemented in each country have lowered the support levels and “decoupled” payments by making them independent of farmer production decisions or market conditions. Clearly, these reforms were in part motivated by the compromises adopted at the Uruguay Round which encouraged countries to adopt this decoupling mechanism plus there was a pledge for a 20% reduction in domestic support programs over the 1994-2000 period.

But beyond the multilateral compromises, did NAFTA per se play any role in given countries greater incentives to adopt these reform policies?. The evidence presented in Burfisher et al (1998) seems to suggest that this is so. In particular, free regional trade in agriculture effectively limits the ability of NAFTA members to maintain independent farm programs because the pressures of market arbitrage tend to unify prices. Thus this market forces makes price support programs and other supply managed mechanism more expensive and less effective for the governments.

For example, the Mexican government, in anticipation of the price reduction effect that NAFTA will have on agriculture prices, corn in particular, launched in October of 1993 the PROCAMPO program. This was a 15-year, direct payment scheme that compensated producers for the loss of input subsidies, price support and import protection. The idea was to provide transitional, mostly decouple income support to farmers while at the same time allow Mexico’s agriculture to undergo a structural change in response to market conditions. On the other hand, Canada’s refusal to liberalize trade in poultry, dairy and eggs was associated to the political decision to maintain price support and production associated subsidies to these sectors. These programs need to be completed with trade restrictions in order to make them more effective.
Regarding export subsidies, the CUSTA prohibits its use in the case of bilateral trade between USA and Canada. Still, under NAFTA, that is, for the bilateral trade between US and Mexico and between Canada and Mexico, export subsidies are permitted if the importing country agree to them, or the importer country is benefiting from imports subject to subsidies from third countries. The agreement establishes a series of consultation procedures and a working group on agriculture subsidies in order to set objective limits, monitor and evaluate the effect of export subsidies in the regional market.

3.2 The political economy of agriculture protection in US and NAFTA

Was the NAFTA liberalization of agriculture trade barriers significant? It certainly seem to be the case if we compared the results with what ended up to be the compromises at the UR round. At that forum countries committed to convert into tariffs-rate-quotas all existing quotas and licenses, but with almost no changes in market access, and very moderate reductions in the levels of over-quota tariffs (a 36% cut applied to a very inflated initial level). This contrast had led some analyst to be very optimistic about the NAFTA results (see Hufbauer and Schott (1993)). Certainly, in the case of the Mexico-US bilateral agreement the fact that there was no permanent exclusion was a quite remarkable result.

Still, from another perspective, it can be said that if US maintained previous to the agreement very low, non-discriminatory (MFN) barriers to trade in agriculture then the indicated elimination in tariff and non-tariff barriers within NAFTA was not that remarkable. The information described from Table 26 suggests that in a number of agriculture products that has not been the case. This table presents information on the level of support provided by domestic farm programs and the protection provided by trade policies. Column 1 shows the Producer Subsidy Equivalent estimated for year 1991 (as % of farm income); Column 2 and 3 present estimates of border protection, including the existing tariff (column 2) at the beginning of the NAFTA negotiations and also an
estimation of the tariff equivalence of quantitative barriers (calculated as the difference between domestic and world prices).

We see that grains and oilseed products have been in general subject to lower border protection, but some of them have received significant support from domestic farm programs. This has been specially the case for wheat, rice and barley with PSE equivalent estimates equal to 53%, 40% and 50%, respectively. Within livestock and poultry, beef has not received significant direct support through farm programs though the presence quantity import restrictions have implied a relative high level of border protection (31% implicit tariffs). The presence of quotas has also been significant for diary, peanuts, and sugar as suggested by the high levels of tariff equivalent estimates (i.e. 95.7 for butter; 70% for cheese, 186% for shelled peanuts, 120% for sugar containing products) and their differences with existing applied tariffs. Some of these products also received a significant level of direct farm support as indicated by the levels of PSE (40% diary, Sugar 52%). Contrastingly, Horticultural products have not been subject, in 1991, neither to significant government subsidies nor quantitative border restrictions. Protection was provided by tariffs, which in general have not been very high with the exception of orange juice (with a 25%-30% rate).

What explains these levels of protection? Its is now common to attribute the structure of protection across sectors to a “political economy equilibrium” where in setting trade and support policies governments take into account both the interest of the involved sectors and also that of the general society, basically those of the consumers (see Grossman and Helpman (1994)). How much the final equilibrium benefits the producer interest against those of the society as a whole depends on how efficient are the producers in terms of organize themselves into lobbies (to solve the coordination problem of, for example, campaign contributions), on how much losses or gains are at stake at the sectoral level (usually measured by the import/export to domestic production ratio) and by the price elasticity of demand for the involved product (an indirect measure of how much consumer welfare is lost by imposing tariff or other border protection).
This framework has already been used to empirical investigate the determinant of MFN protection in US. Goldberg and Maggi (1999) and Gawande and Bandyopadhyay (2000) provide empirical support using mainly manufactured goods. For the specific case of agriculture, Gardener (1987) found that government support raises systematically across commodities when elasticities of supply and demand were low and a larger share of output was imported or exported. Conditional on these variables, factors that facilitated political organization by a sector were also significant.

As indicated by Orden (1998), the above findings are consistent with the patron of protection described in Table 18. In this sense among the exported commodities, levels of support (through subsidies) are positively correlated with export dependence. Besides this, the high level of support obtained by wheat and barley producers may be explained by the lack of alternative production opportunities (inelastic supply) in the dryer parts of the Midwestern grain belt where these commodities are produced. On the other hand, the level of intervention is higher for the moderate number of farms producing grains or dairy than for either the larger number of farms producing beef cattle or the relative small number producing cattle on feedlots, poultry and eggs, cotton, or vegetables and melons.

But then, given the above described political equilibrium behind trade protection in agriculture, why is that NAFTA was successful in liberalizing US agriculture at the regional scale? How NAFTA negotiation helped to change the political incentives toward protectionism in agriculture? Beyond the special reasons (i.e. other non-economic objectives) that the US may have had to push NAFTA, issue that will be discussed later on, there is already a well-established theory that tries to explain the surge of FTAs. This is the so-called political economy explanation of Free Trade Agreement. The seminal work in this area is also associated with Grossman and Helpman (1995) (GH95).

According to this approach, at the heart of whether to form an FTA are political pressures for and against the FTA by the potential losers and gainers due to trade creation and trade diversion. GH95 use the term “enhanced protection” to describe trade diversion and “reduce protection” for trade creation (relative to the tariff-ridden pre FTA situation).
In few words the GH95 approach suggests that exporting interests that are expected to gain the most from trade diversion in the partner country market are those that will be more in favor of a FTA. At the same time those import competing sectors that are expected to suffer the most from trade creation originated in imports from the partner country are the ones who most vividly will oppose the formation of a FTA. The final result will depend also on how efficient are these different groups in influencing government policy through lobby activity, and also the weight in the government objective function of the consumer welfare vis a vis that of the producer groups.

To what extend does the above approach explains the surge of NAFTA? Can we apply this logic to understand the free trade result in agriculture between say USA and Mexico? Alternatively, is NAFTA the outcome of very special circumstances, which can hardly be translated to an eventual US-Mercosur negotiation? In what follow we discuss the plausibility of the GH95 explanation while the second issue is discussed in the next subsection.

For the GH model to be a reasonable explanation of the results of NAFTA we have to find that gains from agriculture US export interest, benefiting from trade diversion in the Mexican market, more than compensated the losses taken by US import competing activities due to decline in domestic production and in prices? How this economic gains and losses translated into lobbing in favor or against NAFTA by these interest groups?

The paper by D. Orden (1996) provides very useful information to address the above questions. In particular, it offers a detailed account of the agriculture provisions negotiation process, especially for the case of the Mexico-USA bilateral treaty, describing how the different agriculture groups influence the final results. We are interested in highlight how, once the high level decision was taken to achieve free trade in agriculture with no exclusion, the US government managed the negotiation to maximize export interest support and minimize the opposition from import competing sectors.
In the US the domestic political process provided multiple points of access for interest groups to influence specific provisions of the agreement. The agriculture producer groups were faced with either seeking concessions related to the parameters of adjustment mechanism or simply opposing the agreement. Table 27 taken from Orden (1996) shows the summary of economic stakes by agriculture sector and their lobby activity in the negotiations. As we would have expected, and predicted by the GH95 theory, there is a high correlation (most sectors are located in the diagonal of the table) between potential economic losses (gains) and political opposition (support).

Thus the export-oriented interest represented by the Corn, Livestock, and Processing Food industries were in favor of the accord and actively support it. This was also the case with Feed Grains and Oilseed producers. On the other extreme, import competing sectors like sugar, peanuts and Florida growers of fruit and vegetables showed a strong opposition. One sector that seems not to correspond with theory is wheat. As we see, in spite of being a sector that potentially could benefit from higher export access into the Mexican market, it strongly opposed the agreement. In this case, the opposition was not based upon issues related to the Mexican-US agreement per se. Instead this group withheld support in a effort to obtain leverage for negotiating market access issues in the Canadian market. In particular they wanted to discipline the Canadian Wheat Board pricing system and wheat transportation subsidies.

But then, how was that, in spite of some strong opposition, a majority bipartisan vote was obtained on November 17 on NAFTA implementing legislation? Were any last moment concessions in favor of those sectors in which eventually trade creation (reduced protection) would occur as a consequence of NAFTA implementation? As indicated by Orden (1996) there was last minute bargaining to assure the majority voting. Nevertheless, on the whole they do not imply a greater deviation from the initial plans of obtaining regional free trade after a period of transition, though as we will see some of these concessions in some cases have strengthen the probability that the trade agreement
generated welfare losses to member (and specially non-member) countries as a consequence of trade diversion.

Thus, the Sugar industry got that consumption of corn sweeteners were included in the determination of net production surplus and that the Mexican sales of Sugar to the US would be 250000 tons from the seventh to the fourteen year. Beyond this, we already indicated (see note 5) that the US government have agreed that additional sugar imports from Mexico will be included in, no additional to, its global TRQ commitment. In the case of Citrus producers (mainly from Florida), they got a sort of price-based safeguard which allowed the US to reinstated the prevailing MFN rate on import from Mexico (for quantities exceeding 70 millions gallons annually through 2002 and 90 millions 2003-07) if the US price of US of fresh concentrated orange juice dropped below an average based upon the proceeding five years for five consecutive days. More important for third country interest, the Citrus sector got the commitment that US cut of MFN tariff under GATT on fresh and processed citrus products was going to be limited to 15%. Also non-NAFTA citrus juices would be classified as perishable commodities to expedite injury claims.

The vegetable sector was favored with a series of administrative concessions like an early-warning import surge mechanism, funding for horticultural research projects and also a promise that NFN tariff cuts on tomatoes, peppers, lettuce, cucumbers, celery and sweet corn will cuts under GATT will be limited to 15%. The wheat sector got the assurance of bilateral consultations to address transportation subsidies and Canadian Wheat Board pricing practices and an ITC investigation of whether imports from Canada interfere with the domestic wheat program. Finally the Peanuts producers were helped with the promise of bilateral consultations to address the increase the peanut butter/past from Canada and an ITC investigation of whether imports interfere with domestic peanut program.

3.3 Nafta’s lessons for Mercosur agriculture exports. The match between US sensitive sectors and Mercosur export supply.
Given the trade barriers face by Mercosur agriculture export to US described in section 2.4 and the experience of NAFTA liberalization described above, what are the chances that these products can be liberalized in a FTA between US and Mercosur? Are the agriculture products that are at the top of Mercosur list “sensitive” from a point of view of the US domestic producers? More generally, can the indicated experience of Mexico and Canada of an almost non-exclusion and deep agriculture liberalization with US be extrapolated to the case of an hypothetical negotiation between US and Mercosur?

A starting point to evaluate these questions could be to measure how “similar” are Mercosur countries to Canada and Mexico from the point of view of their agriculture export supply to the US market. If we find evidence of high degree of similarity we could expect that the same issues arousing within the Nafta negotiations will arise in an eventual Mercosur-USA agreement, and then Nafta is a good starting point to think about Mercosur prospects in the USA market. We evaluate this by computing the Kreinin and Finger “similarity” index (SI) and the Spearmen correlation coefficient between the structures of exports between pairs of countries. The first index takes values between 0 and 100 while the second goes between -1 and 1. We apply these calculations both to 6 digits and 8 digits commodity aggregates. The results are presented in Table 28. We observe that for the case of Argentina we have relatively low values of the similarity index both with Canada and Mexico (9 and 10 for six digits products, 8 and 6 for eight digits commodities, respectively). In the case of Brazil, we find also a low value of the index when comparing with the case of Canada (7 and 6), though it is higher with respect to Mexico (16 and 14). Finally in the case of Uruguay the indexes are very low both with respect to Mexico and Canada. This ordering in general coincides with that described by the Spearmen indicator.

The above evidence suggest that with the possible exception of Brazil with Mexico, the Mercosur countries have an export structure to USA that in general is significantly different from that of USA’s Nafta partners. Thus we might expect that an eventual
The agriculture negotiation between Mercosur and USA will involve a series of new issues, making the Nafta agriculture provisions less significant as a precedent.

We can use the above similarity indexes to derive conclusion regarding another important negotiation issue. That of whether the interest of the Mercosur countries in the US markets are or not coincident. Table 28 also presents the estimation of the SI and the Spearman correlation coefficient for the structure of exports in the US market among Mercosur countries. As we see the SI is much higher between the Mercosur countries than those between them and Canada and Mexico. Argentina have a IS of 22/18 with Brazil and 24/21 with Uruguay, while this latter country has a SI of 16/12 with Brazil. This higher level of similarity is confirmed by the relative large and positive values of the correlation coefficient (i.e 0.6 between Argentina and Uruguay). Clearly, this evidence suggests that there is some overlap in the agriculture interest of Mercosur countries in the US market, which may justify a coordinated action (more on this in the next section).

Another way to evaluate to what extend the results of the Nafta agriculture negotiations are a relevant antecedent for Mercosur is to look at the “shopping list” of these countries, and see how these products were treated in the Nafta negotiations. Were they liberalized? Are they among the most import sensitive products of US?

We already identify that the list of critical Mercosur products include prominently the following commodities (which face important trade barriers in US): Bovine Meat, Chicken and Turkey Cuts, Power Milk, Cheeses and Butter, Citrus (including orange) Juice, Sugar, Peanuts and Tobacco.

The description we presented on the Nafta agriculture negotiations shows that indeed some of the Mercosur key agriculture products were among the most politically sensitive items. This is clearly the case with sugar and sugar containing products. Brazil is a key exporter of these products, even more than Mexico. Recall that sugar was one of the most disputed items in Nafta and the sugar sector agreed to support Nafta at a very late stage in the negotiations and only when assurance were made that any additional market access to
Mexico will be granted at the expenses of third country origins. This implied a reduction of the quota available for third countries like Mercosur exporters.

Milk and other diary products, which are key product for Argentina and Uruguay were also sensitive items within Nafta. In the US-Mexico agreement these products were liberalized within a longer time period (10 to 15 years) and maintained tariff rate quotas during the transition (though the over quota rate has a declining time path). Remember that in the case of the US-Canada provisions, diary were one of the few sector excluded from the agreement.

On the other hand, Bovine fresh cuts received a relative liberal treatment within Nafta, though this could be in part as a result of US being comparatively more efficient in production relative to its neighbors; clearly this could not be the same when US domestic producers face competition from Mercosur countries. Still increasing access of these products by Mercosur countries may in the short run depend more on Mercosur countries’ effort to meet the sanitary (foot and mouth disease, etc.) and taste exigencies (grain fed meat) of the US market.

Citrus (oranges and lemons) are, as indicated, key products for Mercosur countries (oranges for Uruguay, lemons for Argentina). On the other hand Brazil is a worldwide exporter of frozen concentrate orange juice. These were also very sensitive items for US within the Nafta negotiations. A tariff rate quota was set for orange juice which was eliminated only after a 15 year time period and a price-based safeguard was established during the transition in case the domestic price in US fall below a certain value.

Finally, horticultural products, like onions and garlic (key products in the case of Argentina), were also subject to a 10-year period of adjustment within Nafta and market access in the transition was also regulated through a TRQ. In addition these products were subject to a seasonal safeguard provision; this last measure, nevertheless, will be of a less important for Mercosur countries given the off seasonality of its production pattern compared to US.
In spite of these transitory measures of protection applied to these import sensitive products, we have already indicated that Nafta (at least in the Mexico-US provisions) was successful in assuring free trade in these agriculture items in the long run. Can we expect the same to happen with Mercosur countries? Though at this point we can only speculate about this we suspect that there are reasons, some of them going beyond specific trade issues, which make Mercosur countries not similar to Mexico and Canada from the point of view of US domestic politics.

First, of course, we have the condition of bordering state, which has a quite important bearing in the political decision of US to reduce the weight of border protection on trade flows with its frontier economies. Several authors (see, for example, Mayer (1998)) have pointed out that issues associated with migration, internal security, defense; etc have been quite important in the decision of the US government to pursue an FTA with Canada and Mexico and this may have compensated possible sector specific losses from trade liberalization. Clearly these other non-trade reasons are not as important in the case of Mercosur countries and as a consequence will reduce the impulse of US authorities to pursue such negotiations. Second, the behavior of international agriculture markets are quite different now than then. The present scenario with very low prices is quite different from the one faced by Mexico when negotiating with US at the beginning of the nineties (when international prices were at least 20 % higher). In this situation, it could be really costly in political terms for the US government to introduce additional competitive forces in its domestic market via the presence of "new comers".

But better than speculating on why Mercosur may not face the same political will to negotiate agriculture compared to US’s Nafta partners, we can infer the relative importance of this by taking a closer look at recent trade legislation that the US government has issued. We do this in the next section.

4. Mercosur-USA negotiations in agriculture: potential scenarios and outcomes.
In the above section we concluded that the experience of Nafta with regard to agriculture liberalization is not entirely a good, updated precedent of what Mercosur may obtain in a hypothetical negotiation with US. What other pieces of information can we look at to infer the current US position toward agriculture liberalization? We will look at two legislative initiatives recently approved by the US Congress: (a) the “Fast Truck” (FT) legislation; (b) the Farm Bill (FB).

After this analysis we will informally discuss what might be the potential negotiating scenarios that are open to Mercosur countries when pursuing agriculture liberalization with the US. The questions we will address are: Should Mercosur countries seek individual agreements with USA? Should negotiations be arranged as Mercosur and USA? Does ALCA meet some of the demands Mercosur countries have on agriculture liberalization?

4.1 The FT legislation

Though the fast track legislation has not received the final approval yet, there have been already two projects that received Congress approval. The House has passed one in December 2001, and the Senate approved the other in May 2002. The analysis of both projects provides evidence regarding the current political will of US Congress toward agriculture liberalization. The FT legislation has direct bearing with respect to any multilateral and regional agreement that US may enter during 2002-2007. In particular, it applies to multilateral negotiation within the WTO, the bilateral agreement with Chile and Singapore and finally the regional negotiations for constituting the FTAA (see section 6 (a)).

The House legislation has included a general limitation for tariff reduction to be achieved under a multilateral scheme. Tariff cut cannot go beyond 50% of the existing tariffs (section 3 (a) (2) (A)). The legislation, nevertheless, does not impose any additional limitation to agriculture liberalization per se though it states that negotiations in this area should aim at obtaining reciprocal tariff and non-tariff barrier elimination and
provide reasonable adjustment period for import sensitive agriculture products. With regard to these last products the legislation also establishes that the authorities in close consultation with Congress must determine whether any further liberalization is adequate taking into account the consequence of previous agreement, specifically Nafta (see section 2 (10), section 4 (b)). Still no formal definition of what constitutes an agriculture import sensitive item is provided.

The project approved by the Senate goes one step further by defining this critical issue and also by incorporating specific limitations for tariff reduction in agriculture. With regard to the first point, import sensitive items were defined as those for which as a result of the UR agreement: (i) the rate of duty was subject to a tariff reduction in 1995-2001 (ii) became subject to a tariff rate quota after January 1995 (section 2113 (5)). With respect to the second point, the legislation does not allow any further tariff reduction, beyond those agreed upon the UR, in any import sensitive agriculture product (section 2103 (a) (2) (1) (B)).

This limitation, nevertheless, could be waived if: (i) such reductions are included within an implementing bill; (ii) if such reduction are set forth in a negotiation for the reciprocal elimination of duties under the auspices of the WTO (section 2103 (a) (2) (5) and (6)). So the legislation does permit “deep” agriculture liberalization but only within the context of bilateral (or regional) Free Trade Agreements where the reciprocity condition is assured. At the same time gives more power to Congress to determine such cuts by establishing that an additional implementing law is required to approve these changes.

The more restrictive character of the Senate project is also reflected in the fact that it explicitly indicates that the US trade authorities must avoid agreements that lessen the effectiveness of domestic and international antidumping, subsidies and safeguard provisions. This has direct consequences regarding the possibility of effectively liberalizing agriculture given the significant role these mechanisms have played in agriculture trade. Finally the Senate project is more explicit regarding the process of special consultations that should be applied on import sensitive agriculture products
(section2104 (b) 2). It establishes that before negotiating any tariff reduction in the context of the FTAA or a WTO Multilateral Round, the USTR should: (i) consult with Congress whether further reductions are appropriate (ii) request an assessment by the ITC on consequences of any further tariff reduction.

Overall we can conclude that the FT legislation does impose new restrictions to achieve further liberalization in agriculture especially within the context of a multilateral and a continental scheme (FTAA). Still, if anything, it tilts the remaining possibilities toward less comprehensive (in terms of the involved countries) bilateral or regional free trade agreements in which US exporters can benefited from reciprocal market access gains.

4.2 The Farm Bill

A complementary piece of information that also serves to describe the stance toward agriculture liberalization of the US government is the recently approved Farm Bill. The approval of the indicated legislation has generated a great controversy given that some press commentators have argue that it has “monstrously” raised domestic support (see The Economist 2002). In this sense it may be interpreted as a signal of a week instance of US regarding global liberalization in agriculture. The discussion we present below about this legislation tries to answer two questions. First, to what extend does the new law imply a break with the path toward more rational management of these programs agreed upon at the UR negotiations? Second, and more directly related to the purpose of this paper, why the Farm Bill is relevant from the point of view of Mercosur objective of gaining access to the US import markets of agriculture products?

Regarding the first question, the Farm Bill of 2002 replaces the legislation that was passed in 1996, which implemented the UR agreements up to year 2001. That legislation started with the process of creating subsidies that de-couples payments from current production and prices (the Facility Contract Program) and also stipulated an overall compromise for a reduction in total domestic support from the base year (1986/88). The actual behavior of direct government payments to farmers was that they increased
dramatically since 1998 as a consequence of low commodity prices. Thus the average of payments per year in 1999/2001 were above 20 billions dollars (with the record high in 2000 of 22.1 billions). Much of the additional funds to farmers in those years were canalized through ad hoc emergency assistance, which was enacted through 5 legislative packages since 1998. The remaining of the additional funds were given through the Marketing Loans Deficiency and Marketing Loan Gains programs whose payments are very sensitive to current prices. These additional expenditures more than offset the observed reduction of de-coupled support during the 1996-2001 period.

The Farm Bill of 2002 basically does three things: a) maintains and extends (to soybeans and peanuts) the decouple payment programs, now called Fixed Direct Payments. Under this scheme the funds received by the producer depend on production decision made in 1998-2001 and the payment rate in fixed already in the law; (b) replace all the ad-hoc emergency assistance support by a new program called Counter Cyclical Income Support Payments. This payments are based upon historical production, though it is somewhat distorting as the final income received depends on the difference between the targeted prices and current prices. (c) It extends the Marketing Assistance Loans (and Marketing Loans Deficiency Payments) to new products (peanuts, mohair, wool and honey), fixing the loan rates in the legislation. This is the most distorting program of all as payments depend not only on current prices but also on current production decisions\(^\text{ii}\).

Besides the above changes the legislation also extended the coverage of the Land Retirement Program (an increase of 11% out of a total of 39 million acres), raising conservation expenditures of about 3 billions dollars over a 10 year period. The effect of this change could potentially help to reduce commodity supply and support commodity

\(^{ii}\) It allows the producer to receive a loan from the government at a commodity specific rate and pledge production as collateral. The farmer may pay the loan at maturity in three alternative ways: at a very low interest rate, by forfeiting the pledge crop, or at an alternative repayment loan rate. When current prices of crops decline this last repayment rate also declines (in general equals the local posted county prices) so the repayment rate is significantly lower than the original loan rate. Thus these programs create incentives to produce specific crops, especially those that prices have fallen the most. Estimates produced by the Economic Research Service of USDA (see ERS 2000) have calculated that with marketing loan benefits ranging from around 5 billion to over 8 billion between 1999 to 2001, total acreage planted in the eight major field crops has increases by 2-4 millions acres annually.
prices though in practice the final effect will be modest as the additional acres to be retired represent only 2% of the total harvested cropland (see ERS/USDA 2002)). Finally the Farm Bill included specific schemes for diary and peanuts (recall this are key commodities for Argentina and Uruguay)\textsuperscript{iii}. With respect to diary, there is a support purchase program where the government buys at support prices milk, butter, cheddar cheese and non-fat dry milk. This is complemented with a diary export incentive program that pays exporters a bonus when they buy US products and export them when international prices are below domestic prices. This program is subject to WTO restrictions agreed upon the UR agreement. Finally the peanut program has been greatly redesigned in the 2002 legislation by incorporating this crop to the general form of support applied to other crops\textsuperscript{iv}.

Overall it has been estimated (see ERSA/USDA 2002) that the implementation of these entire support programs will imply government fund of about 179 billion during the next 10 years (2002-11). This amount represent an increment of 72 millions with respect of what would be spent if the basic framework of the 1996 Farm Act were to be applied. Thus in this sense the new legislation raises the total amount of subsidies. But this is not a fair comparison given that it does not incorporate the actual value of support given in the last three years which, as indicated, was around 20 millions dollars per year. So taking into account this information the Farm Bill consolidates a (great) part of the ad-hoc support received recently by the farm sector.

Now, what it is important is not so much the amount received as the effect of these resources on domestic production and exports. Here the news brought by the Farm Bill are mixed. The de-couple schemes are extended to other product replacing much distorting regimes (i.e Peanuts), but at the same time maintains and extend to new

\textsuperscript{iii} There has been also changes produced in the
\textsuperscript{iv} Before, production for domestic consumption was limited to an annually established quota designed to uphold prices to 610 per ton. Under the new legislation the marketing quota system is eliminated and peanuts are treated similarly to other program crops. Thus farmer no longer have to have to own or rent a quota rights to produce. Compensation is provided for to quota holders for the elimination of the quota system.
product the much distorting Marketing Assistance Loans Programs raising in some cases the loans rates. Thus the key objective for free-subsidy countries, like Mercosur, is to ask for a process where de-couple mechanism gain participation within total support.

Going now to the issue of the relevance of the Farm Bill for Mercosur countries access to the US market, we think that the Farm Bill is important because there is a complementary between border protection and domestic support, which we already saw played some role in the case of Nafta. The key issue is that when domestic support is aimed at maintaining current domestic prices and is not de-coupled from current production, the reduction in border barriers will imply increasing amount of government support triggered by declining internal prices. In this situation, we would expect that the decision to liberalize a given agriculture sector will be also accompanied by a change in its support scheme in the case that it is incompatible with the reduction in border barriers. We already saw this in the case of Nafta when Mexico changed its support regime toward corn in the face of increasing competition from US as consequence of Nafta. On the contrary, Canada pressured to exclude diary from the Nafta agreement because this was inconsistent with its domestic programs aiming at maintaining domestic prices.

What are the good or bad news that the Farm Bill brings in this respect? We see that most of the support payments in the Farm Bill are not directed to maintain domestic prices (though they do try to main farmer income). As a consequence, domestic prices, especially for grains, have in general been equalized with international prices. The good news for Mercosur (specially Argentina) comes from the fact that the new legislation has changed the support to the Peanut sector, which in the past had the objective of maintaining domestic prices and now takes a similar shape as that of other crops. This will increase the possibility that in the future the US government may decide to lower trade barriers for this product. The bad news comes from diary. This is because under the new legislation the government support is still oriented at maintaining current prices. Thus any reform that reduces border protection and as a consequence reduces domestic prices will imply a significant increase in benefit payments, which in turn will make the
program financially unviable. We may take the decision of the Congress (of not changing the support scheme for diary) as a signal that further liberalization for this product is not “politically” desired.

4.3 The prospects for a Mercosur-US negotiation on agriculture: bilateralism, regionalism and multilateralism.

Given the conclusions we arrive from the Nafta experience and the above described restrictions coming from the recent legislation approved by Congress, what are the potential negotiating scenarios that are open to Mercosur countries when pursuing agriculture liberalization with the US?. Should Mercosur countries seek individual agreements with USA? Should negotiations be arranged as Mercosur and USA? Does ALCA meet some of the demands Mercosur countries have on agriculture liberalization?

Before discussing negotiating strategies we may want to recall what are the main agriculture issues that Mercosur countries have with respect to the US market (the so called “shopping list”). First we have border barriers for some key agriculture products within which the most important are: Bovine Meat, Chicken and Turkey Cuts, Power Milk, Cheeses and Butter, Citrus (including orange) Juice, Sugar, Peanuts and Tobacco. Second, we have export subsidies and third other types of domestic support mainly for those crops which Mercosur countries, mainly Brazil and Argentina, are also major producers (i.e. corn, soybeans, wheat).

Starting with the issue of trade barriers we see that many of the Mercosur key products consist of import sensitive items as defined by the FT legislation. In this sense these items are subject to tariff rate quotas in US, or, as in the case of citrus and citrus juices, they were subject to tariff cuts under the UR agreement; thus qualifying as import sensitive commodities.

There is already some evidence showing that these FT restrictions are influencing current efforts at bilateral trade liberalization. In the case of the Chile-US negotiations Ramirez-Valdez (2002) indicate that the initial US position has been to defined three
types of categories: those products whose tariff will be eliminated immediately, those with a phase-out period of 4 years and a third with a 8-year period. Finally there is also a fourth group of sensitive products including bovine meat, cheeses and other diary as well as sugar for which a quota system will be applied. Ramirez and Valdez have calculated that almost 73% of Chile exports to US fall within this sensitive import group, for which effective liberalization is subject to a great amount of uncertainty.

Of course the above experience of Chile is easily translated to Mercosur. Indeed we would expect that this sensitive product category would cover even a larger amount of exports given the greater comparative advantage (with respect to Chile) that Mercosur countries have in these sensitive items. So, is there any way out of these restrictions?

The main issue regarding border barriers is that of reciprocity. As the FT legislation indicates the key that could open the way for meaningful liberalization in these sensitive products is to assure that US exporters get similar opportunities in the other markets. Here is where we think that a negotiation strategy where Mercosur countries negotiates as an entity with US could be much more productive. The gain from potential market access for US producers will be of much important magnitude specially when considering the size of the Brazilian market. This could be the only scenario in which US might be willing to significantly reduce border barriers in those agriculture products that, being sensitive for its domestic interests, are at the same time quite critical for Mercosur countries (in the sense that gains from any FTA are substantially reduced if these goods are not included). Having said this, we also need to be realistic. Mercosur countries could not expect to obtain the same treatment as Mexico and Canada. Though the first best is to have outright tariff and non tariff elimination, a “managed” process where quota levels are progressively raised even during a long period of adjustment will also be important as a long term signal.

Still the negotiation between Mercosur and US should not only concentrate on lifting barriers on these sensitive items. There are also gains from a coordinate action in issues like phytosanitary standards. Today the certification of these standards is done by
domestic agencies, which are not mutually recognized. This originated the establishment of non-automatic import licensing, which have also discriminate Mercosur export in the US market. This is the case, for example, with Brazil exports of Chicken, which are affected by the fact that Brazil has not certificated that its chicken are free of the “New Castle Disease”. A FTA framework between US and Mercosur could provide the institutional framework for these type of cooperation to be reached beyond what already has been obtained within the UR framework (which is very little).

Another area where a Mercosur-USA framework may also be productive (again compared to UR results) is that of restricting export subsidies for inter-regional trade. The negotiation of this issue within Nafta was not sensitive and current US position is in favor of a strongest policy in this area. On the other hand, domestic support programs are clearly an item of the global agenda that have to be negotiated at the multilateral level. Nafta made very little improvements in this respect (other than some unilateral decisions taken by some of the involved countries, like Mexico). More recently, US trade authorities when negotiating with Chile have clearly put the issue aside. Yet Mercosur, given its importance in global agriculture, could trade off market access into US in exchange for a strong international position in favor of a change in the design (not so much the level) of domestic support with the aim of making these subsidies less prompt to affect production and export decisions.

Can the above results be obtained through the current process of FTAA? The initial position of US trading authorities regarding agriculture at the FTAA meetings (see Noguez (2001) and www.ustr.gov) was to obtain free trade in agriculture products and the elimination of export subsidies. If this were to happen, it clearly meets the Mercosur's "shopping list". Now the problem is that, as we saw, the FT legislation so far approved imposes some restrictions for achieving deep trade liberalization on a FTTA basis. Even beyond these institutional restrictions, given the greater amount of countries involved, it is quite possible that the actual degree of trade barrier reduction to be achieved through this scheme will be lower compared to a Mercosur-US framework. The key issue here is that the quality of enforcement mechanisms (i.e. dispute settlement bodies) will be
debilitated when regional integration embraces too many countries of great differences in size and institutional performance. In any case the development of negotiations both at the FTAA and also at the Mercosur-US level are not necessary incompatible; some of the provisions reached at the bilateral level will be part of the Free Trade Area of the America initiative, while others will be restricted to the Mercosur-US framework as it will happen with Nafta.

5. Concluding Remarks.

In this paper we have investigated the pattern of agriculture trade of Mercosur countries with US. We have shown that the Mercosur region has significantly lost participation in the US import market in the last 13 years. It is difficult to determine in what proportion this lost in participation was occurred as a consequence of trade diversion. Certainly an important part of the increase in US imports is the result of a process of trade creation that took place within the Nafta region; Mexico and Canada exports raised as a consequence of reduction in trade barriers. Still for the case of some specific product like preparation of vegetable and fruit and meat and its preparation we do identify that part of Mercosur exports have been diverted away to US Nafta’s partners.

In light of this evidence we try to investigate which are the agriculture products that Mercosur countries are efficient at production and see whether they are subject to tariff and non-tariff barriers in the US market. We conclude that the divergence found for some products between the comparative advantage indicators calculated for the world and for the US market is in part a consequence of the presence of border barriers in the United States economy. Within this list of key Mercosur products, the ones that face the strongest barriers are Bovine Meat Fresh and Frozen, Chicken and Turkey Cuts, Power Milk, Cheeses and Butter, Citrus (including orange) Juice, Sugar, Peanuts and Tobacco. On the other hand, grains like Corn, Sunflower and Soybeans, as well as oil and other products made out of Soybeans, face very low border protection in US though they are supported by significant direct government payments. Thus the apparent difficulty of
Mercosur exporters (mainly Argentina and Brazil) is due to the fact that US is also a major producer and exporter of these items.

The description we presented of the Nafta agriculture provisions shows that indeed some of the Mercosur key agriculture products were among the most politically sensitive items. In spite of this, Nafta, at least in the case of the Mexico-US agreement, was successful in assuring free trade in these agriculture items in the long run. The question then arises if the same could happen with Mercosur countries.

Clearly there are very important non-economic reasons that have pushed the US government to establish a FTA with Mexico and Canada. Among them the most important is the condition of bordering states and how this influences issues associated to migration, internal security and defense. Clearly these other non-trade reasons are not as important in the case of Mercosur countries and as a consequence will reduce the impulse of US authorities to pursue such negotiations.

We have looked at recent US Congress legislation for more updated inference about the political will of US to pursue further liberalization in agriculture. We concluded that the Fast Truck legislation does impose new restrictions to achieve further liberalization especially within the context of a multilateral and a continental scheme (FTAA). Yet, if anything, it tilts the remaining possibilities toward less comprehensive (in terms of the involved countries) bilateral or regional free trade agreements in which US exporters can benefit from reciprocal market access gains.

On the other hand, the Farm Bill has produced a change in the design of some sector specific schemes (i.e Peanuts) that makes them less inconsistent with trade liberalization. This will increase the possibility that in the future the US government may decide to lower trade barriers for this product. Still on other cases like Milk the government support is still oriented at maintaining current prices. We may take the decision of the Congress (of not changing the support scheme for diary) as a signal that further liberalization for this product is not “politically” desired.
From the analysis of the recent US legislation we conclude that the main issue regarding border barriers is that the key that could open the way to meaningful liberalization in the import sensitive agriculture products is reciprocity, that is, to assure that US exporters get similar opportunities in the other markets. Here is where we think that a negotiation strategy where Mercosur countries negotiates as an entity with US could be much more productive. The gain from potential market access for US producers will be of much important magnitude specially when considering the size of the Brazilian market. This could be the only scenario in which US might be willing to significantly reduce border barriers in those agriculture products that, being sensitive for its domestic interests, are at the same time quite critical for Mercosur countries. Having said this, we also need to be realistic. Mercosur countries could not expect to obtain the same treatment as Mexico and Canada. A “managed” process where quota levels are progressively raised even during a long periods of adjustment will also be important as a long term signal.

Still the negotiation between Mercosur and US should not only concentrate on lifting barriers on these sensitive items. There are also gains from a coordinate action in issue like sanitary and fithosanitary standards. Today the certification of these standards is done by domestic agencies, which are not mutually recognized. This originated the establishment of non-automatic import licensing, which have also discriminate Mercosur export in the US market. A FTA framework between US and Mercosur could bring the necessary institutional cooperation for these type of cooperation to be reached beyond what already has been obtained within the UR framework (which is very little).

Another area where a Mercosur-USA framework may also advanced considerably (again compared to UR results) is that of restricting export subsidies for interregional trade. Nafta negotiation of this issue was not sensitive and current US position is in favor of a strongest policy in this area. On the other hand domestic support schemes is clear an item of the global agenda that have to be negotiated at the multilateral level. US when negotiating with Chile have clearly put the issue out of the agenda. Yet Mercosur, given its importance in global agriculture, could trade off market access into US market in
exchange for a strong international position in favor of a change in the design (not so much the level) of domestic support schemes less prompt to affect production and export decisions.

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