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Report Coordinators
Terri Raney, John Link

Contributors
Ed Allen, Mark Ash, Tom Capehart, Nathan Childs, Wilma Davis, Xinquen Diao, John Link, Ron Lord, Steve MacDonald, Susan Pollack, Terri Raney, Peter Riley, Scott Sanford, Shayle Shagam, Agapi Somwaru, James Stout, Julieta Ugaz-Pereda, and Constanza Valdes.

Technical Editor
Diane Decker

Production/Design
Wynnice Pointer-Napper
Victor Phillips, Jr.

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INTERNATIONAL AGRICULTURE AND TRADE REPORTS

FREE TRADE IN THE AMERICAS
Situation and Outlook Series

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Summary

Participation in Hemispheric Free Trade Area a Plus for U.S. Agriculture

A Free Trade Area of the Americas (FTAA) is one of several trade agreements that the United States is encouraging and actively pursuing.

An FTAA that eliminates tariffs among the 34 Western Hemisphere countries would benefit the U.S. agricultural sector and the U.S. economy as a whole--if the United States were part of the arrangement. If the other Western Hemisphere countries formed an FTAA without the United States, the impact on the U.S. agricultural sector and the general U.S. economy would be slightly negative. In either case, the expected economic impact of an FTAA on the United States would be very small in the short run (3-5 years), primarily because tariffs in the region are already relatively low and are being further reduced through bilateral and multilateral agreements.

Further, broad-based trade liberalization could boost economic growth by stimulating investment and reallocating capital and other resources toward more productive uses. This process could create additional economic gains over the long term beyond the static effects captured in this analysis.

The U.S. interest in forming an FTAA comes, in part, from the broad U.S. goal of fostering economic and political stability in the hemisphere and from a desire to secure more open and

transparent rules for U.S. trade and investment in the rapidly growing markets of Latin America. An FTAA, like all other trade arrangements, could help the countries in the region "lock in" the economic reforms they have already adopted, improving the long-term outlook for growth and stability in the hemisphere, and deepen the trade liberalization that is currently taking place. It could simplify the complex system of regional and bilateral trade preferences that is emerging in the hemisphere. It would also ensure that U.S. exporters gain or retain access to regional markets on a basis comparable to other exporters. The key findings are:

- o An FTAA that includes the United States would cause annual U.S. farm income (in 1992 dollars) to be \$180 million higher than it would be otherwise. An area that excludes the United States would cause annual U.S. farm income to be an estimated \$50 million lower. These represent very small changes in U.S. farm income, which was around \$50 billion in 1997.

- o Including the United States would increase annual U.S. agricultural trade as well, with exports \$580 million higher (1 percent) and imports \$830 million higher (3 percent). If the United States is not included, annual U.S. agricultural exports would decline about \$130 million (0.2 percent), while imports would be \$90 million (0.3 percent) lower.

- o An FTAA would have virtually no impact on gross domestic product (GDP) in the short run. Annual U.S. GDP would be about \$3.8 billion higher annually with a full FTAA, while an FTAA that excludes the United States would lower U.S. GDP by \$740 million.

- o With an FTAA, the United States and Canada should increase their wheat market share in Brazil. If U.S./Brazil phytosanitary problems are resolved, and given competitive transport costs to Northeast Brazil, the U.S. share of Brazil's imports would likely increase further.

- o Implementation of an FTAA, with or without U.S. participation, would have little impact on U.S. rice sales in the Western Hemisphere, where transport costs are a more important factor than the existing low tariffs. The United States dominates rice exports to Mexico and Central America, largely because cheaper Asian rice is banned in many countries for phytosanitary reasons. As long as these restrictions remain in place, U.S. exports are expected to remain stable.

- o The gains in corn trade for the United States from participating in an FTAA would be positive but modest. An FTAA without U.S. participation is likely to cause diversion in corn trade with Argentina exporting more to Latin America and less to the rest of the world.

- o U.S. soybean exports would be expected to benefit from the removal of tariffs. An FTAA would expand soybean oil sales to the

Caribbean, and would cause several countries that now crush soybeans to import soybean meal and soybean oil instead. Brazil, Argentina, and the United States would compete for the expanded soybean product exports, with the United States at some disadvantage if it were not a member of the FTAA.

- o The impact of an FTAA on U.S. cotton would be relatively small, regardless of whether the United States was a member. Marginally higher U.S. exports could result from an arrangement that includes the United States. U.S. imports would probably change far less than exports.

- o U.S. meat trade would not be significantly affected by an FTAA, regardless of whether the arrangement includes the United States, because it is assumed that current health and sanitary requirements will remain unchanged. U.S. imports of beef, pork, and poultry are restricted by sanitary regulations that require countries shipping uncooked beef, pork, or poultry to be certified as free of foot and mouth disease, swine fever, and Newcastle disease. These diseases are considered endemic in most Latin American countries, which thus cannot export fresh or chilled meat to the United States. These restrictions are unlikely to be affected by an FTAA, although regionalization could be a factor.

- o Dairy trade also is unlikely to be significantly affected by an FTAA. Argentina has free access to the Brazilian market under the MERCOSUR agreement. If the United States received the same access, U.S. exports could displace some of Argentina's exports to Brazil. At the same time, U.S. imports from Argentina could expand.

- o A hemispheric FTAA that liberalized U.S. sugar trade could have major implications for the U.S. sugar industry. U.S. prices, production, and exports could decline significantly, and imports could increase. U.S. consumers would have access to inexpensive imported sugar, especially from low-cost producers like Guatemala and Brazil.

- o Lowering or reducing tariffs under an FTAA would have little effect on U.S. orange juice exports, which have grown in recent years as domestic demand has stabilized. However, there could be an incentive for the United States to import more Brazilian orange juice.

- o A hemispheric FTAA would likely have little impact on the U.S. tobacco market. Current U.S. trade policies for tobacco are not very restrictive (Brazil, the major U.S. supplier, filled only 68 percent of its allotment during the first year that the current tariff-rate quota was in place), so further liberalization is not likely to have much impact on U.S. imports. U.S. exports of tobacco leaf and cigarettes are unlikely to be adversely affected by an FTAA.

o Peanuts could be affected by an FTAA. U.S. producers of "additional" peanuts currently dominate the world export market, indicating that this segment of the industry can compete effectively at world prices and could benefit under an FTAA. U.S. producers in the traditional "quota" production areas of the Southeast might have difficulty competing at world prices, at least in the short run. Liberalization of the U.S. peanut market under an FTAA would likely imply a continued movement of the industry away from the traditional production areas.

o Canada and Mexico might be slightly better off with an FTAA that excludes the United States than with a full FTAA, because the two countries already benefit from trade liberalization with the United States under NAFTA. In an FTAA including the United States, the preferences currently enjoyed by Canada and Mexico would be extended to the rest of the hemisphere, eroding some of their gains from NAFTA.

Free Trade in the Americas: Introduction

In April 1998, President Clinton and the heads of state of 33 other Western Hemisphere countries met at the second Summit of the Americas in Santiago, Chile, to launch formal negotiations for a Free Trade Area of the Americas (FTAA). The FTAA 1/ was originally proposed at the first Summit of the Americas, held in December 1994 in Miami, Florida. The Miami summit was followed by a series of four "ministerial" in which the trade ministers of the participating countries met to lay the groundwork for the formal negotiations. The trade ministers' final declaration in March 1998 called for negotiations to begin at the Santiago summit and to be completed by the year 2005.

1/ The early work of Hufbauer and Schott (1994), *Western Hemisphere Economic Integration*, Institute of International Economics, focused on what issues the FTAA negotiations should cover, how the negotiations might be structured, and what the implications of an FTAA might be for the hemisphere countries as well as for the rest of the world.

The trade ministers called for the FTAA negotiations to be consistent with the World Trade Organization and to improve upon WTO rules and disciplines wherever possible and appropriate. The WTO requires that free trade areas cover substantially all trade among members and that trade barriers against outsiders not be increased (see box "Free Trade Areas ..."). Discussions for the FTAA are to proceed simultaneously in nine negotiating groups, including a separate group on agriculture. The other groups are market access; investment; services; government procurement; dispute settlement; intellectual property rights; subsidies, antidumping, and countervailing duties; and competition policy.

The U.S. interest in forming an FTAA stems, in part, from the broad goal of fostering economic and political stability in the hemisphere and from the narrower goal of securing more open and

transparent rules for U.S. trade and investment in the rapidly growing markets of Latin America. An FTAA could help the countries in the region "lock in" the economic reforms they have already adopted, improving the long-term outlook for growth and stability in the hemisphere. Further, an FTAA could simplify the complex system of regional and bilateral trade preferences that is emerging in the hemisphere and ensure that U.S. exporters gain or retain access to regional markets on a basis comparable to that granted to other exporters.

The Americas include markets for U.S. agricultural exports, suppliers of agricultural imports for the U.S. market, and competitors with U.S. agriculture in third markets. Therefore, how the FTAA evolves may have important implications for the United States.

Agricultural Trade in the Americas 2/

The United States is by far the largest agricultural exporter in the Americas with \$66.3 billion in export sales for 1996, the latest year for which comparable trade data are available for all countries in the hemisphere (appendix table). This compares with \$14.7 billion and \$14.3 billion, respectively for Canada and Brazil, the region's second and third largest agricultural exporters. As the richest and most populous country in the Americas, the United States is also the largest market for agricultural products, importing \$37.9 billion in 1996. Canada is the second largest agricultural importer with \$9.5 billion, followed by Mexico and Brazil with \$7.6 billion and \$6.3 billion, respectively.

2/ Trade data in this section are from the United Nations and the Foreign Agricultural Trade of the United States. The data sources are not completely compatible.

U.S. Trade with the Americas

Total agricultural trade between the United States and the other countries of the Americas is growing rapidly, doubling since 1990 to almost \$37 billion in 1997. In terms of total value, U.S. agricultural imports from the Americas--\$19.7 billion-- slightly higher than U.S. exports to the region--\$17.2 billion (figure 1). In terms of shares of U.S. trade, however, the region is substantially more important as a source of imports for the United States than as a destination for U.S. exports. About 50 percent of all U.S. agricultural imports come from Western Hemisphere countries, while only about 25 percent of U.S. agricultural exports go to the region. Canada and Mexico dominate U.S. agricultural trade, together supplying about 30 percent of total U.S. imports and taking 20 percent of total U.S. agricultural exports. This asymmetry in U.S. import and export market shares is even more pronounced for the other Western Hemisphere countries, which together supply almost 25 percent of total U.S. agricultural imports but purchase only 5 percent of

U.S. agricultural exports.

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Free Trade Areas the the World Trade Organization

Article XXIV of GATT 1994 permits governments to form free trade areas, subject to specific conditions. A free-trade area is an agreement among two or more countries to eliminate customs duties and other restrictions on substantially all trade between them in products originating in such countries. The Understanding on the Interpretation of Article XXIV concluded in the Uruguay Round of multilateral trade negotiations clarifies and strengthens the GATT disciplines applying to free trade agreements.

In general, the purpose of a free trade area should be to facilitate trade between the constituent countries and not to raise barriers to the trade of other WTO members with such countries. Accordingly, with respect to a free trade area, or an interim agreement leading to the formation of a free trade area, the duties and other regulations of commerce maintained in each of the constituent countries and applicable at the formation of a free trade area or the adoption of such interim agreement to the trade of members not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent countries prior to the formation of the free trade area or interim agreement, as the case may be.

Any interim agreement leading to a full free trade agreement shall include a plan and schedule for the formation of such a free trade area "within a reasonable length of time." The Uruguay Round Understanding on the Interpretation of Article XXIV states that this length of time should not exceed 10 years other than in exceptional cases.

GATT 1994 requires governments to notify the WTO when entering into a free trade agreement or an interim agreement leading to such an arrangement and be subject to a transparency review. The WTO Committee on Regional Trade Agreements conducts these reviews and reports the results of the review to the relevant WTO oversight body.

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The United States as a Supplier of Agricultural Products for the Americas

Looking at regional trade from the perspective of agricultural importers reveals that the United States is a vital source of agricultural products for the region. As noted above, only about 25 percent of all U.S. agricultural exports go to the Americas, but the United States supplies almost 45 percent of the agricultural goods imported by the region (figure 2). U.S. dominance is strongest within NAFTA where the United States supplies 66 percent of the agricultural products imported by

Canada and Mexico, and weakest in MERCOSUR with only 11 percent of that market. The dichotomy is most striking for the Central American and Caribbean countries, which together take less than 10 percent of all U.S. agricultural exports, but where the United States supplies almost 40 percent of their agricultural imports. Similarly, less than 10 percent of U.S. agricultural exports go to the Andean countries, but the United States supplies more than 25 percent of their agricultural imports.

In NAFTA, the United States maintains a strong market share not only for total agriculture but also for each of the major product groups (grains, oilseeds, livestock products, and horticulture). Conversely, in MERCOSUR where the U.S. share of total agricultural imports is low, the U.S. share of each of the major product groups is also low. This pattern suggests that proximity of markets, factor endowments, and perhaps, broad-based trade agreements play a strong role in determining where U.S. exports dominate. Proximity to the Canadian and Mexican markets and participation in NAFTA provide U.S. farmers with a strong competitive edge. Conversely, distance from the Southern Cone and exclusion from MERCOSUR create substantial impediments to U.S. agricultural exports. The same pattern does not hold for the Andean Group or for Central America and the Caribbean, where U.S. market shares vary considerably by commodity category, with relatively strong U.S. performance in bulk and intermediate goods, and relatively weak U.S. performance in horticultural and consumer goods.

Market Shares Changing Over Time

Looking at changes in regional agricultural markets over time shows that the United States has gained market share since the early 1990s throughout the hemisphere except in the Andean Group. The U.S. share of the NAFTA partners' total agricultural imports has increased more than 5 percentage points since the early 1990s. The U.S. share of MERCOSUR's agricultural imports has increased almost 3 percentage points since the early 1990s, despite the introduction of trade preferences among MERCOSUR members. This suggests that the MERCOSUR'S common external tariff (CET) is creating trade opportunities for nonmembers as well, by lowering the external tariffs for most agricultural products entering MERCOSUR markets from outside the region. The U.S. market share has increased more than 5 percentage points in Central America and the Caribbean.

U.S. Agricultural Imports from the Americas

NAFTA is the dominant supplier for the U.S. market, accounting for 31.9 percent of all U.S. agricultural imports, more than the rest of the Western Hemisphere combined. Another 22.3 percent of the U.S. agricultural import market is split among the Andean Group, Central America, and MERCOSUR. The Caribbean countries supply about 1.5 percent of U.S. agricultural imports, primarily sugar.

About 26 percent of U.S. imports are classified as noncompetitive, mainly tropical products that are not grown domestically, such as coffee and bananas (figure 3). The Western Hemisphere accounts for about \$5 billion or 54 percent of the noncompetitive total. NAFTA makes up only about 14 percent. Competitive imports account for about 74 percent (\$ 27 billion) of total U.S. agricultural imports, with the Western Hemisphere providing 54 percent of the \$27 billion. Interestingly, on the competitive side NAFTA accounts for 38 percent of these imports.

During the 1990s, the NAFTA partners' share of the U.S. import market for all agricultural commodities increased about 6 percentage points (from 23 percent in 1990 to 29 percent in 1996), while MERCOSUR'S share decreased about 3 percentage points (from 9 percent to 6 percent). This suggests that the NAFTA agreement may have created trade preferences for Canada and Mexico at the expense of the MERCOSUR countries.

Economic Policy Reform and Free Trade in the Americas

The past two decades have witnessed a remarkable transformation in the policy environment for agriculture in the Americas, as most countries in the hemisphere have adopted more market-oriented policies. Trade reform, particularly through the formation of regional and bilateral preferential trade arrangements, is a key feature of the new policy environment in the region (table 1).

The policy transformation has been most dramatic in Latin America where, until the mid-1980s, most countries followed the policy prescriptions of the "import-substitution" strategy for economic development. Broadly speaking, this strategy held that substituting domestically produced goods for imports by supporting local industries and conserving foreign exchange --would stimulate a country's economic growth. In implementing this strategy, many countries taxed agricultural exports and imposed high import barriers on agricultural inputs to subsidize industrial development. Government monopolies directly controlled agricultural trade in many countries, particularly for basic agricultural commodities. Besides discouraging investment in the agricultural sector, the policies constrained economic growth far below its potential. Latin America was wracked by the international debt crisis of the early 1980s, and the ensuing economic stagnation lingered throughout the decade. Chronic government deficits and bouts of hyperinflation also plagued the region, forcing many countries to re-examine their economic policies.

Chile was the first country in Latin America to adopt fundamental economic reforms, abandoning the import-substitution strategy in favor of more market-based economic policies. Chile implemented unilateral trade reforms in 1985, adopted a flat 20-percent ad valorem tariff for almost all trade, and progressively lowered

that tariff to 11 percent by the mid 1990s. Chile does not provide domestic agricultural price supports or direct export subsidies and, in general, charges only the flat 11-percent tariff on agricultural imports. Chile maintains a price band system for wheat, wheat flour, vegetable oil, and sugar imports that operates like a variable levy to insulate domestic markets from international price fluctuations. In addition to adopting unilateral tariff reductions, Chile has formed regional trade agreements throughout the hemisphere to foster further trade reforms. Chile became an associate member of MERCOSUR in 1996 and has bilateral agreements with a number of countries in the region, including Canada. Chile's price-band commodities are partially liberalized in the MERCOSUR and Canadian agreements, meaning that Chile will gradually phase out the 11-percent tariff but the price-band levies will continue to apply.

By the end of the 1980s, Argentina had begun the transition to more market-based policies as well. Argentina's 1989 Convertibility Plan fixed the Argentine peso at parity with the U.S. dollar, halting hyperinflation and eliminating the use of differential exchange rates that had implicitly taxed the agricultural sector. In addition to this implicit tax, Argentina previously controlled its domestic agricultural sector through the use of export taxes, marketing boards, high import tariffs, inspection fees, and various registration systems. Argentina has since eliminated export taxes on agriculture except for unprocessed oilseeds (3.5 percent) and raw hides (15 percent). Argentina also abolished its marketing boards for beef, grains, sugar, and dairy and privatized its railroads and port facilities, substantially improving its export capacity (figure 4).

In the Uruguay Round Agreement on Agriculture, Argentina agreed to establish a tariff ceiling of 35 percent for agricultural imports plus a 3-percent statistical tax. Argentine trade policy now emphasizes free trade among the MERCOSUR partners and a significant reduction of external tariffs and non-tariff barriers on imports. Argentina now applies the MERCOSUR common external tariff (CET), which for agricultural goods varies between zero and 20 percent depending on the product. The freeing-up of the economy during the past few years has reduced these import barriers to relatively low levels and eliminated or simplified much of the red tape previously required of importers.

Since the early 1990s, Brazil has undertaken a massive program to stabilize its macroeconomy and liberalize markets. Like most countries in Latin America, Brazil traditionally protected its agricultural sector through high and variable tariff rates, complex import licensing requirements, and agricultural marketing boards. Brazil maintained minimum guaranteed floor prices and government-held stocks for basic commodities and provided subsidized credit to farmers. At the same time, Brazil taxed its agricultural sector through the imposition of export taxes and an array of state taxes.

The 1995 Real Plan pegged the Brazilian currency, the real, to the U.S. dollar and brought inflation down from 5,000 percent to single digits by 1996. Federal budget constraints led to the gradual elimination of many agricultural subsidies, including the guaranteed minimum price program, government-owned buffer stocks, and low-cost credit. The Brazilian government still assesses a 40-percent export tax on sugar above a certain amount to help guarantee a sufficient domestic supply for alcohol production. Import licenses are no longer used to restrict trade, and Brazil eliminated the state sales tax (ICES) on exports of primary and semimanufactured goods, including agriculture, in 1996. Brazil now applies zero tariffs on most agricultural imports from MERCOSUR partners and the relatively low MERCOSUR CET on imports from outside the region.

The 1991 MERCOSUR trade agreement among Argentina, Brazil, Paraguay, and Uruguay was a pivotal development in the market reforms undertaken in Latin America. MERCOSUR eliminated most trade barriers among the members and established a CET for most agricultural products by 1995, with longer transition periods for a few sensitive agricultural products such as dairy. The MERCOSUR CET is lower than its members' previous external tariffs for almost all agricultural and food products (figure 4). Argentina's average external tariff on agricultural goods exceeded 20 percent before MERCOSUR, with tariffs as high as 40 percent for many products. Brazil's average agricultural tariff before MERCOSUR was almost 60 percent, with many items carrying tariffs of 100 percent. The CET is capped at 20 percent for almost all agricultural goods (though Brazil maintains tariffs as high as 30 percent for certain dairy products), and averaged about 12 percent in 1995.

MERCOSUR is expanding rapidly, adding Chile and Bolivia as associate members in 1996. The associate members eliminate trade barriers with the other MERCOSUR members and associates but retain their existing external trade policies with nonmembers such as the United States. MERCOSUR concluded a bilateral agreement with Mexico in 1997, and is currently discussing agreements with Canada and the Andean Group (Bolivia, Colombia, Ecuador, Peru, and Venezuela).

The United States, Canada, and Mexico also adopted fundamental policy reforms for agriculture during this period. Most notable were the elimination of transportation subsidies under the Western Grain Transportation Act (WGTA) in Canada on August 1, 1995, the implementation of the Uruguay Round Agreement (URA) in 1995, Canada's Net Income Stabilization Account (NISA) in 1991, the Federal Agricultural Improvement and Reform Act of 1996 in the United States, and Mexico's implementation of the PROCAMPO program in 1993. These policy reforms have substantially reduced government intervention in agricultural markets and liberalized agricultural trade, again using regional trade agreements as an avenue for agricultural trade reform. Through

the 1989 U.S.-Canada Free Trade Agreement (CFTA) the United States and Canada have eliminated most barriers on bilateral agricultural trade. Under NAFTA, which subsumed the CFTA in 1994, the United States and Canada will eliminate most agricultural trade barriers with Mexico by 2008.

Trade Agreements in the Hemisphere

NAFTA and MERCOSUR are the largest and most comprehensive regional trade arrangements in the Western Hemisphere, but a multitude of other trade agreements were established or re-activated during the past decade (figure 5). About 40 trade agreements currently exist, and at least another dozen are under negotiation. In addition to NAFTA and MERCOSUR, the major agreements in the hemisphere include the Andean Group, the Central American Common Market (CACM, comprised of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua), and the Caribbean Community and Common Market (CARICOM, comprised of 13 Caribbean nations). As noted above, Chile has been very active in pursuing bilateral agreements, most recently concluding accords with MERCOSUR (1996) and Canada (1997). In addition to its membership in NAFTA, Mexico also participates in the Group of Three with Colombia and Venezuela, has an agreement with Costa Rica, and has or is discussing bilateral agreements with most countries in the region, including those in MERCOSUR.

Most of the agreements in the hemisphere are reciprocal, meaning that the members extend comparable trade preferences to each other, as in NAFTA and MERCOSUR. In addition, the United States and Canada--the wealthiest countries in the hemisphere--grant non-reciprocal trade preferences to most of the smaller countries in the region. For the United States, the Generalized System of Preferences (GSP), the Caribbean Basin Initiative (CBI) and the Andean Trade Preference Act (ATPA) give preferential access to the U.S. market for most of the smaller countries on a non-reciprocal basis.

The proliferation of trade agreements means that most countries in the hemisphere are involved in multiple agreements. This "spaghetti bowl" of overlapping commitments has given rise to calls for a comprehensive, hemisphere-wide agreement. A major goal of the proposed FTAA is to turn this multitude of agreements into one comprehensive agreement.

A Free Trade Area of the Americas: Alternatives for U.S. Agriculture

Economists usually classify the effects of preferential regional trade agreements as "trade creating" and "trade diverting." Trade creation occurs if the preferential tariffs permit producers in one member country to sell into a previously protected neighboring market without affecting imports from nonmembers. Trade diversion occurs if the preferential tariffs cause importers to switch from more efficient suppliers outside of the

agreement to less efficient suppliers within the agreement.

As a member of a hemispheric FTAA, the United States would be expected to gain from the trade creating effects of such an arrangement. By not taking part, the United States could risk losing market share in the FTAA countries. However, a free trade area may spur income growth for its members, stimulating their demand for imports from nonmembers as well as from other members. In this way, countries could benefit from the formation of an FTAA even if they were not members.

Analyzing an FTAA

Our analysis of the economic implications of an FTAA involves a two-step process. First, we use a computable general equilibrium model (CGE, see box "Notes on the Data...") to obtain the economywide and sectoral effects of such an arrangement, cognizant of the broad commodity aggregations for agriculture in the database. Then, we use the findings of the model and supplement them with other relevant agricultural market and policy information to provide detailed commodity impacts. This approach allows us to take into account the important linkages between agriculture and the rest of the economy and also permits us to capture the uniqueness associated with certain agricultural commodities.

The CGE model is global in the sense that all regions in the world are covered. Production and consumption decisions in each region are determined within the model following behavior that is consistent with economic theory. Multilateral trade flows and prices are determined simultaneously by world market clearing conditions. In other words, prices adjust to ensure that total demand equals total supply for each commodity in the world. The general equilibrium feature of the model means that all economic sectors agricultural and nonagricultural--are included. Hence, resources can move among sectors, thereby ensuring that adjustments in the feed grains and livestock sectors, for example, are consistent with adjustments in the service sector.

The model is static in the sense that the supply of resources (labor, capital, and land) is fixed. This means that the gains from stimulating investment and productivity growth that would be expected as a result of trade liberalization are not captured in the model. The model allows the existing resources to move among sectors, thereby capturing the effects of the more efficient resource allocation that results from trade liberalization.

The simulations were designed to isolate the effects of further economic integration in the Americas from the effects of other hemispheric trade policies that were adopted previously. First, a stylized view of the countries with the full implementation of existing trade agreements and domestic policies in the region was developed. Specifically, the NAFTA, MERCOSUR, and Uruguay Round GATT/WTO agreements were fully implemented in the base scenario.

Due to data limitations, other trade agreements in the hemisphere were not included. Second, two alternative scenarios were then examined. In the FTAA+US scenario, a full hemisphere-wide free trade arrangement (FTAA+US) was simulated by eliminating all tariff barriers in the Americas. The results of the analyses are reported as changes relative to the base scenario, either in value or in percentage terms. In the FTAA-US scenario, a hemispheric free trade arrangement excluding the United States (FTAA-US) was simulated. In this scenario, all of the countries in the Americas except the United States eliminate tariffs among themselves, while trade policies between those countries and the United States remain unchanged.

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Notes on the Data for the FTAA Computable General Equilibrium Model

The FTAA CGE model was developed by ERS and the University of Minnesota. The major parameters of the model on production, consumption, trade, and policy measures were calibrated from the Global Trade Analysis Project (GTAP) database, version 3, which represents the world as of 1992, currently the most recent data available. The model includes the following countries and aggregated regions: the United States, Canada, Mexico, Argentina, Brazil, Chile, Central America and Caribbean, the Andean Group, the European Union-15, Asia, and the Rest of the World. The agricultural sector is subdivided into the following commodity aggregations: rice, wheat, feed grains (corn, barley, sorghum), non-grain crops (oilseeds, peanuts, fresh fruits and vegetables, sugar, and cotton), livestock, meats, dairy and dairy products, beverages and tobacco, and other processed food products. The other sectors in the database are aggregated into two broad categories: manufacturing and services.

The estimated impacts of an FTAA depend critically on the initial level of protection and the degree of liberalization assumed in the model. Trade measures for the regions and commodities are represented as ad valorem tariff equivalents in the GTAP database (table 2). It is difficult to represent the initial levels of protection precisely, because specific tariffs, non-tariff barriers and technical standards cannot be quantified exactly for all countries and sectors. The difficulty is compounded because the country and commodity categories in the database represent aggregations. Non-grain crops, for example, obviously include a wide range of products, with broadly varying degrees of protection. However, even a category like wheat includes diverse products that face varying import restrictions. In the model, trade liberalization is simulated by reducing the ad valorem tariff equivalents. Furthermore, trade liberalization does not necessarily imply the elimination of all trade-distorting barriers. For example, sanitary and phytosanitary standards may restrict trade even after tariff barriers are eliminated. Therefore, the tariff equivalent is not reduced to zero in the model even when the tariff component is eliminated.

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Estimated Impacts of an FTAA

According to ERS analysis, the United States could benefit from membership in an FTAA but could be negatively affected if an FTAA were formed without U.S. participation. The estimated economic effects of an FTAA for the rest of the hemisphere are also generally positive, but the question of U.S. membership is important to the outcome. The global effects of an FTAA are positive, with benefits to members more than offsetting losses to outsiders, and the global gains are larger if the arrangement includes the United States.

The estimated impacts of an FTAA on the U.S. economy are small for every economic indicator used in this study: gross domestic product, agricultural income, and agricultural trade. Trade liberalization is already occurring among the hemisphere's major trading partners through the NAFTA and MERCOSUR agreements, so the additional liberalization under an FTAA would be relatively small. The results are small primarily because the tariff reductions under an FTAA would be small. Furthermore, because the static framework used in this analysis accounts for benefits generated by re-allocation of resources, it fails to account for changes in capital investment and factor productivity that would likely result from an FTAA in the long run.

Estimated Effects of an FTAA on Gross Domestic Product in the Americas

For the United States, joining the FTAA is preferable to remaining outside, but in either case the impacts on U.S. GDP are very small (figure 6). GDP for the United States is estimated to be \$3.8 billion (0.06 percent) higher with U.S. membership than it would be with no agreement. Conversely, GDP for the United States is estimated to be \$740 million (0.01 percent) lower if the FTAA excludes the United States.

The static impacts of an FTAA on the U.S. economy are small primarily because the incremental tariff reductions under the FTAA are small. The NAFTA agreement with Canada and Mexico is fully implemented in the base scenario, meaning that the United States has already liberalized trade with its two main trading partners in the hemisphere before the FTAA tariff reductions are implemented. Furthermore, the static framework captures only the short-run effects of trade liberalization. In the short run, trade liberalization causes the existing stock of productive resources in each member country to be reallocated according to comparative advantage, improving the economic efficiency of members. The small estimated static impacts of an FTAA on U.S. GDP implies that an FTAA would not cause significant resource movements within the U.S. economy. In the long run, however, growth in investment and productivity could generate larger gains for the United States.

For Canada and Mexico, an FTAA that excludes the United States would have a small positive effect on their respective GDPs, but if the agreement includes the United States, their GDPs would be lower than with no FTAA at all. This occurs because, in the FTAA+US scenario, the NAFTA preferences currently enjoyed by Canada and Mexico are, in effect, extended to the rest of the hemisphere. On the other hand, in the FTAA-US scenario, Canada and Mexico retain their exclusive NAFTA preferences while gaining additional preferences (relative to the United States) in other markets in the hemisphere. Again, these results reflect only the short-run effects of trade liberalization. In the longer run, the economic stimulus provided by a broader FTAA than covered in this analysis could offset the short-run loss to Canada and Mexico caused by the erosion of their NAFTA trade preferences. The effects of the FTAA on Canada and Mexico are small in either scenario because, like the United States, they have already liberalized trade with their most important regional partners through NAFTA.

By similar reasoning, GDP for Argentina and Chile could also be hurt by U.S. membership in the FTAA, because they would face increased U.S. competition in other regional markets where they currently receive preferential access. The Andean countries and Brazil are estimated to benefit from an FTAA in terms of GDP regardless of whether the United States is a member, but they gain more without U.S. participation. Central America and the Caribbean benefit from the formation of an FTAA, and their gains are larger with U.S. participation. In both scenarios, the GDP gains within the hemisphere more than offset the losses that accrue to the rest of the world, with a substantially larger net gain (\$1.5 billion) in the FTAA+US scenario. It should be emphasized that these estimated GDP impacts are very small in percentage terms, less than 0.2 percent everywhere except for Central America and the Caribbean. The FTAA has its largest effect on GDP in the Central American and Caribbean countries, where GDP is almost 1 percent higher in the FTAA+US scenario than with no agreement. This suggests that the lowest-income regions in the hemisphere stand to benefit the most from U.S. participation in an FTAA.

Estimated Impacts of FTAA on Agricultural Income

Trade liberalization in the Americas has a slightly larger and more beneficial impact on the agricultural sector than on the economy as a whole, because many countries in the hemisphere have a comparative advantage in certain types of agricultural production and because agriculture is generally more highly protected than other sectors. The analysis shows that under a FTAA+US scenario, agricultural income would be higher for the world as a whole and for every country/region in the Americas except Mexico. Moreover, only Canada and Mexico would have higher agricultural income in an FTAA without the United States than in an agreement that encompasses the entire hemisphere (figure 7).

For the United States, agricultural income is about \$180 million (0.08 percent) higher if the U.S. joins the FTAA and about \$50 million (0.02 percent) lower if the U.S. does not participate. In both scenarios, the percentage impacts on U.S. farm income are the smallest in the hemisphere.

Mexican agricultural income is slightly lower in both FTAA scenarios than in the base scenario, with greater losses if the United States is a member (\$ 90 million or 0.2 percent lower vs. \$40 million or 0.09 percent lower in FTAA-US). These results suggest that the gains accruing to Mexican agriculture under NAFTA might be eroded slightly under a hemispheric FTAA. Canadian agricultural income, in contrast, is higher in both FTAA scenarios, but with slightly more gains if the United States is excluded. For Canada, agricultural income is \$500 million (1.5 percent) higher in FTAA+US and \$600 million (1.8 percent) higher in FTAA-US.

For all the other regions in the hemisphere and for the world as a whole, agricultural income is higher with both FTAA scenarios than with no arrangement, but highest with U.S. participation. The Andean Group would gain about \$450 million (1.7 percent) in farm income under FTAA-US, with a tiny increase if the United States is included. U.S. participation is more important for Brazil, where farm income would be \$550 million (1.2 percent) higher in FTAA+US but remain almost the same in FTAA-US. Central America and the Caribbean also would gain substantially more in terms of farm income if the United States is a member--\$350 million (2.5 percent) higher in FTAA+US compared with \$100 million (0.07 percent) higher in FTAA-US.

Estimated Impacts of FTAA on Agricultural Trade

Membership in an FTAA would increase U.S. agricultural trade --both imports and exports--relative to the base scenario. Conversely, exclusion from an FTAA would cause U.S. agricultural imports and exports to be lower than without an agreement. In the FTAA+US case, total U.S. agricultural imports would be \$830 million (3 percent) higher and exports would be \$580 million (1 percent) higher than in the base, implying that the net U.S. agricultural trade surplus would be \$250 million lower. Conversely, in the FTAA-US scenario, total U.S. agricultural imports are \$90 million (0.3 percent) lower and exports are \$130 million (0.2 percent) smaller, for a net trade surplus that is \$40 million lower (figure 8). The farm income increases, though small, indicate that the U.S. agricultural sector benefits from the overall growth in trade. The sector further benefits by more efficient allocation of productive resources within the sector and in the general economy (figure 8).

For every other region in the hemisphere, agricultural exports would be higher in either FTAA scenario than in the base, and highest with U.S. participation everywhere except for Canada and

Mexico. The two NAFTA partners would be slightly better off, in terms of agricultural exports, if the United States does not participate in the FTAA, because they would retain preferential access to the U.S. market while gaining additional preferences in other regional markets.

Similarly, agricultural imports are higher than the base with either FTAA scenario everywhere in the hemisphere except the United States. The question of U.S. participation makes little difference in the value of agricultural imports for the NAFTA partners or the MERCOSUR members, but it is important for the Andean Group and for Central America and the Caribbean where agricultural imports are substantially higher if the United States participates in the FTAA.

In the FTAA+US case, the largest export value gains for agriculture would accrue to Brazil (\$830 million) and the Andean countries (\$650 million), followed by the United States (\$580 million), Canada (\$480 million) and Argentina (\$350 million). In percentage terms, the Andean countries would gain the most (10.2 percent), followed by Brazil (8.3 percent), Chile (6.5 percent), and Central America and the Caribbean (4.3 percent).

The largest import value increases in the FTAA+US scenario would be for the United States (\$830 million), Central America and the Caribbean (\$780 million), and the Andean Group (\$580 million). In percentage terms, the largest import increases would be for Central America and the Caribbean (19 percent) and for the Andean Group (16 percent), followed by Brazil (10 percent) and Chile (8 percent). While the United States would have the largest import value increase under FTAA+US, in percentage terms the increase (3 percent) is among the smallest in the hemisphere (figure 9).

Effects of an FTAA on Selected U.S. Agricultural Commodities

The agricultural sector, from the farm gate through processing channels, is covered in the FTAA model by the following commodity categories: rice, wheat, feed grains, non-grain crops, livestock, meat, dairy, beverages and tobacco, and other food products. Clearly some of the aggregations are broad from an agricultural perspective. For instance, the non-grain" category includes sugar, peanuts, and oilseeds, commodities that are key to any hemispheric trade analysis. Moreover, the FTAA model does not take into account some of the recent changes in trade patterns and policy regimes that might impinge on specific commodity effects. The degree of aggregation in the underlying data base does not permit us to generate commodity-specific impacts from the model for the following commodities: orange juice, peanuts, cotton, tobacco, and sugar. In those cases, our analysis relies on other market and policy information.

Estimated Effects of FTAA on Agricultural Trade

Within the total \$580-million increase in U.S. agricultural

exports in the FTAA+US scenario, the greatest gains would be for grains, beverages and tobacco, and other processed food products (table 3) with most of the increase going to the Andean Group and to Central America and the Caribbean (figure 10). U.S. exports of rice, wheat, and other grains would be higher by \$88 million, \$33 million, and \$95 million, respectively. Beverages and tobacco exports would be \$118 million higher and other food products would be \$200 million higher. The United States has a strong export presence in these products and could benefit from reduced tariffs and higher incomes in the region. Membership in the FTAA would allow U.S. exporters to compete on an equal footing with other exporters such as Canada and Argentina (figure 10).

Total U.S. exports of livestock and meats would be virtually unchanged and dairy exports would decline slightly in the FTAA+US case. For livestock and meats, U.S. exports would increase slightly within the hemisphere--primarily to the Andean Group and to Central America and the Caribbean--but U.S. exports would decline outside the hemisphere, as trade patterns adjust to reflect the new trade policies.

Within the \$830-million increase in U.S. imports in the FTAA+US scenario, the largest value and percentage increases for U.S. imports would be for non-grain crops (\$267 million or 3.1 percent), beverages and tobacco (\$183 million or 3.4 percent), and other processed food products (\$299 million or 3.6 percent) (table 4). As noted above, these categories also would experience export gains, reflecting the fact that they are broad aggregates and suggesting, perhaps, that opportunities exist for further specialization within these categories in the hemisphere.

In the FTAA-US scenario, total U.S. agricultural exports would be \$130 million (0.2 percent) lower than in the base. By commodity category, the largest U.S. export losses would be for wheat (\$69 million) and processed food products (\$45 million), followed by dairy (\$15 million) and beverages and tobacco (\$17 million). Most of the U.S. agricultural export losses in the FTAA-US case would occur in the Andean Group and in Central America and the Caribbean, again reflecting competition for these markets between the United States and the hemisphere's other major exporters. The change in total U.S. agricultural imports in the FTAA-US scenario is small (\$90 million or 0.3 percent lower) and is spread fairly evenly over commodities, with no single category changing by more than 0.5 percent.

Implications of an FTAA for Selected Commodities

Wheat

Current U.S. Policy

The U.S. most favored nation (MFN) import tariff on durum wheat is \$6.90 per metric ton for most countries. Under NAFTA, Canadian wheat is duty-free and the tariff on Mexican wheat, currently

\$3.00 per metric ton, will be completely phased out by 2002. For an overview of U.S. agricultural policy see The 1996 U.S. Farm Act Increases Market Orientation, ERS, AIB No. 726.

U.S. Wheat Trade With the Americas

The United States, Canada, and Argentina are forecast to account for just over half of world wheat exports in 1998/99. In recent years, the combined exports from Canada and Argentina about equaled U.S. exports. The Western Hemisphere accounts for about 20 percent of global wheat imports, and is a crucial arena for competition between these exporters, as other exporters play only a very minor role. In 1996/97, U.S. wheat exports captured 30 percent of Western Hemisphere imports.

Current wheat trade patterns in the Western Hemisphere are influenced by NAFTA and MERCOSUR trade agreements. Currently, Argentina enjoys the lion's share of Brazil's growing imports, partly because of lower tariffs (0 instead of 10 percent) as part of MERCOSUR, and partly because phytosanitary barriers in Brazil have barred U.S. wheat since the end of 1996. Transport costs, MERCOSUR-reduced tariffs, and foreign exchange considerations favor Argentina as a supplier to Brazil, the Hemisphere's largest importer. However, Brazil's millers prefer to import some higher quality, high-protein wheat from Canada or the United States to blend with locally grown low-protein wheat.

Possible FTAA Effects on Wheat Trade

With an FTAA, Argentina is likely to lose wheat market share in Brazil to the United States and Canada, or to Canada if the United States does not participate. If U.S./Brazil phytosanitary problems are resolved, and given competitive transport costs to Northeast Brazil, the U.S. share of Brazil's imports would likely increase further if the United States participated in an FTAA.

In Mexico, the United States and Canada have equal access under NAFTA. An FTAA would not likely change current trade patterns with Mexico. Because of the considerable shipping distance, Argentina would not normally be expected to export wheat to the United States or Mexico even under an FTAA, so North American wheat trade would remain largely unchanged.

Most of the rest of Latin America produces relatively little wheat and largely depends on imports to meet domestic demand. Moreover, import demand for wheat is relatively inelastic, so lower tariffs are unlikely to generate significant additional import demand. An FTAA would not be expected to change wheat food aid shipments to the region under PL-480 or other donation programs.

If the United States did not participate in an FTAA, expanding the advantage that Argentina currently enjoys with low MERCOSUR tariffs to the rest of Latin America would hurt U.S. export

prospects. But even more damaging would be the elimination of tariffs on Canadian wheat. While Argentina tends to compete with the lower end of U.S. quality and protein, Canada competes at the higher end. If the United States did not have the same access as Canada and Argentina, the U.S. export share to the Western Hemisphere (currently 30 percent) could drop enough so that the lost sales could not easily be made up in the rest of the world. U.S. prices would be reduced, and U.S. production would be lower. Meanwhile, Canada would have an incentive to shift additional resources into wheat production. So, nonparticipation in an FTAA would hurt U.S. wheat exports, and reduce wheat grocers' incomes.

However, an FTAA would probably reduce the share of Argentina's wheat exports to the hemisphere, regardless of whether the United States participates, because Argentina's current preferential access to the Brazilian market (MERCOSUR) is likely worth as much or more than its potential gains in Latin America outside of MERCOSUR. Both Canada and the United States stand to gain by joining an FTAA, with all the benefits accruing to Canada if the United States stays out.

Rice

Rice Market and Policies

The United States is the third largest rice exporting country, typically accounting for almost 15 percent of world rice exports. Because about 45 percent of the U.S. rice crop is exported, activities in the world rice market are critical to the well-being of the U.S. rice sector. Further, Latin America is becoming a much more important market for U.S. rice exports.

Imports account for all of Canada's rice consumption. Mexico, the Caribbean, and Central America import a substantial share of their rice use. South America both imports and exports rice. Argentina and Uruguay--members of MERCOSUR--are the largest exporters; Guyana, Ecuador, and Surinam export smaller quantities. Ecuador is a member of the Andean Pact and Guyana is a member of CARICOM. The bulk of South American exports are to Latin American countries where exporters have preferential trade status due to various regional trade blocks. South American rice is typically quoted in international markets at prices comparable to--or higher than--U.S. rice. Brazil is South America's largest importer, typically taking a million tons a year. Peru, Colombia, and Chile regularly import rice as well.

The United States currently places tariffs on imported rice ranging from 2.1 cents a kilogram for rough rice to 1.7 cents a kilogram for regular milled rice, and 0.99 cents a kilogram for basmati rice. The U.S. imports about 10 percent of its total domestic use and imports are accounting for an increasing share of domestic use. Imports are overwhelmingly high-priced Asian aromatic varieties--mostly from Thailand, India, and Pakistan --that are not currently capable of being grown in the United

States or Latin America. The FTAA could slightly increase South American exports to the United States, but gains would be very small due to transportation cost, no price advantage, and the high quality of U.S.-grown rice.

Tariff rates in Latin America for rice imports from countries that are not members of NAFTA, MERCOSUR, CARICOM, or the CACM vary among countries, but are generally declining. Price bands and tariff rate quotas are used by some countries as well.

Prior to GATT-WTO membership, Central America had imposed fairly high tariffs on rice imports. The WTO membership set upper bounds for tariffs and reduced tariffs. Previously, most countries in Central America used price bands to protect domestic markets but have shifted to more transparent and less distorting policies.

U.S. Rice Trade with the Western Hemisphere

The Western Hemisphere is the most important market for U.S. rice exports. In 1997/98 the United States shipped a record 1.7 million tons (product-weight basis) to Western Hemisphere countries, accounting for a record 60 percent of total U.S. rice exports. While trade in 1997/98 was especially high due to production shortfalls in some Latin American countries, U.S. rice exports to the region had been rising steadily for over a decade. In fact, U.S. rice exports to the Western Hemisphere have doubled since 1990/91.

Latin America has been the fastest growing market for U.S. rice exports for the past decade, and accounts for at least 90 percent of U.S. exports to the Western Hemisphere. The bulk of U.S. exports to Latin America is rough rice. Latin American countries prefer to import rough rice because most have excess milling capacity.

Two policy factors account for much of the U.S. export expansion to Latin America. First, most countries in the region apply a lower tariff to rough rice than to brown and milled rice. Second, many countries in the region impose strict phytosanitary restrictions that block importation of Asian rice.

Possible Impacts of a Free Trade Area on Rice Trade

With Asian rice currently blocked from many markets--and most of Latin America already joined by trade blocks--the impact of the FTAA on total rice trade will not be very large. For the United States, the primary impact of the FTAA will be on exports. The United States is currently the dominant supplier to Canada, Mexico, and Central America, but faces stiff competition from MERCOSUR exporters in South America and from Guyana in the Caribbean. The impact of the FTAA varies by market.

Because Mexico is in NAFTA, the FTAA would have little impact on U.S. trade with Mexico. Also, because most South American rice is

exported within the region and Mexico prefers to import rough rice, the FTAA would have little impact on South American trade. Mexico already has a bilateral trade relation with MERCOSUR.

U.S. rice exports to Central America might benefit slightly from membership in the FTAA as U.S. rice would not face tariffs. However, tariffs on rough rice are already quite low in most countries and rates on milled rice have been reduced as part of WTO requirements. If the United States does not join the FTAA, South American exporters would face lower tariffs than the United States in Central America. Yet, the region's growing preference for rough rice indicates Central America could remain a viable growing market for the United States.

The United States does not typically export much rice to South America except for Peru. This is partly due to regional trade blocks that give advantages to South American exporters. Members of MERCOSUR can export rice at zero tariffs to other members. Similarly, tariff rates are zero among CARICOM members. Argentina, Uruguay--and to a lesser degree Ecuador--supply the bulk of South America's import needs and all three are members of regional trading blocks. Venezuela both imports and exports rice, with Colombia the primary destination. Both countries are members of the Andean Pact. Guyana ships mostly to CARICOM and indirectly to the EU. However, South American countries do turn to the United States if regional supplies are insufficient. Many South American countries, including Peru, Colombia, and Ecuador, have phytosanitary regulations that effectively ban Asian imports. This has allowed the United States to be the prime source of rice to South American when production shortfalls occur.

U.S. participation in an FTAA would make the United States more competitive in several markets in South America, likely increasing U.S. exports to some markets--such as Brazil, Colombia, Chile, and Peru. The location advantage enjoyed by Argentina and Uruguay will allow these two exporters to remain dominant in the Brazilian market. U.S. membership in the FTAA would help the United States compete with Thailand and Vietnam in certain markets--such as Brazil. However, U.S. milled prices and lower U.S. transportation cost would still be uncompetitive with Asian rice even with U.S. membership in the FTAA. If the United States does not join, South American exporters will retain the tariff advantages they already have under various regional trade blocks.

The United States exported nearly 280,000 tons of rice to the Caribbean in 1997/98. The United States has lost Caribbean market share since the early 1990s to Guyana, which has preferential trade status as a member of CARICOM. Caribbean countries import primarily milled rice. U.S. milled prices--excluding tariffs are competitive with Guyana's. U.S. membership in the FTAA would likely allow the United States to regain some of its lost market.

Canada imports primarily from the United States and to a less

degree Thailand and India. The United States exports more than 100,000 tons a year to Canada. High-quality Asian rices have been gaining a larger share of the Canadian market. NAFTA reduced U.S. tariffs to Canada to zero in 1998. The FTAA would lower tariffs on rice from South American exporters, possibly displacing a small amount of U.S. rice. However, the United States would likely remain dominant given its transportation advantage, established market, and reputation for high quality. South American rice does not sell at a discount to U.S. rice in international markets.

Corn

Current U.S. Policy

U.S. import tariffs on corn and other feed grains are 0.7 cents a kilogram for countries outside of NAFTA, and free for NAFTA countries. For an overview of U.S. agricultural policy see The 1996 U.S. Farm Act Increases Market Orientation, ERS, AIB No. 726.

U.S. Corn Trade with the Americas

In 1996/97 the Western Hemisphere imported 11.5 million tons of corn, with 78 percent coming from the United States. The Western Hemisphere was the destination for almost 20 percent of U.S. corn exports.

Argentina is the only serious competitor in the hemisphere, but is also the second largest corn exporter in the world, and is in direct competition with U.S. corn in many key markets outside the Western Hemisphere.

The United States has negotiated increased access to Mexico's corn market as part of NAFTA, and this study assumes that Mexico is unlikely to make additional concessions in an FTAA. Given the location of Mexico's livestock and broiler industries, ports, and rail links, it is unlikely that Argentina can overcome the logistical and transportation advantages that the United States enjoys when shipping to Mexico. Similarly, Brazil is expected to be an increasing net corn importer over time, but--except for the extreme northeast --logistics and transportation costs make Brazil a natural market for Argentina, with MERCOSUR already giving Argentina preferential access.

Possible FTAA Effects on Corn Trade

The key Western Hemisphere corn markets that would be influenced by an FTAA would be Venezuela, Colombia, Ecuador, Peru, the Caribbean, and Central America. These countries are expected to import about 6 million tons of corn in 1998/99, about 10 percent of world corn trade. Even if Argentina captured 100 percent of these markets as a result of preferential access under an FTAA without U.S. participation, it would still face direct

competition from U.S. corn in other parts of the world for about half its corn exports. Because prices are determined on the margin, the overall price in Argentina would continue to be set by the competition with U.S. corn where that competition is most direct--in this case, outside the Western Hemisphere. If the U.S. share of Latin America's corn imports fell as a result of not participating in an FTAA, it would likely increase to other markets, minimizing overall losses. An FTAA without U.S. participation is likely to cause trade diversion in corn trade with Argentina exporting more to Latin America and less to the rest of the world. However, global market shares would be relatively unchanged under either scenario.

Moreover, even if the United States did not participate in an FTAA, Argentina would never be able to capture 100 percent of the Western Hemisphere corn markets because transportation costs and seasonal price variations (the corn harvest drives down prices about 6 months later in Argentina than in the United States) would make U.S. corn competitive in most of these markets for at least part of the year, regardless of any tariff advantage.

Limited gains for both Argentina and the United States are likely if tariffs are eliminated under an FTAA, which reduce corn importers' internal prices and those countries who are less efficient in corn production respond by producing less and consuming more. However, in most Latin American countries a significant portion of domestic corn is used for human food, while imported corn is used for feed because it does not have food quality characteristics, making substitutability limited. Consequently, eliminating tariffs is unlikely to have a significant effect on the production or consumption of corn for food.

Most Western Hemisphere corn importing countries support corn production with domestic support programs that extend beyond simple tariffs. These supports would likely limit production declines even after tariffs are eliminated. As a result, trade gains following from an FTAA tariff elimination are expected to be modest.

Other Coarse Grains

Trade in other coarse grains is mostly sorghum and barley. Only Mexico is a significant sorghum importer, and the United States dominates this market. Argentina is unlikely to make substantial gains in Mexico as a result of an FTAA. The competition between Argentina and the United States in the world sorghum market is similar to that in corn, but world barley trade is distinct. World barley trade is dominated by the EU, but Canada is a large exporter and the United States is a minor exporter. The FTAA would likely help Canada increase barley exports to Latin America, mostly malting barley, replacing the EU or causing the EU to increase its subsidies. However, the FTAA could also generate unexpected results in niche markets. For example, an

FTAA could help Argentina's fledgling malting barley exports penetrate the lucrative malting barley markets in Colombia and Central America, especially if a failure to participate in an FTAA kept the United States out of the competition.

Cotton

Current U.S. Cotton Policy

U.S. cotton production policy is similar to that for other major field crops, with support provided through production flexibility contracts that are unrelated to production decisions. A marketing loan program is in place to provide a price floor for U.S. cotton producers while assuring cotton is available to the market regardless of the price. Where cotton's marketing loan program differs from those for other commodities is its promotion of consumption. U.S. cotton exports and domestic mill use of cotton have been supported by payments under Step 2 of the marketing loan for much of the 1990s. USDA makes step 2 payments to domestic textile mills and cotton exporters during weeks that U.S. prices exceed comparable world prices by more than a 1.25 cent per pound threshold, and transportation adjusted world prices remain below another threshold. Step 2 payments for exports have typically added more than 100,000 bales annually to U.S. exports, but are unlikely to be a factor after 1999 due to the exhaustion of funds originally earmarked to last through 2002.

Import policy for cotton is also affected by the marketing loan program. As currently authorized, the cotton marketing loan program introduces flexibility into tariff-rate quota (TRQ) levels for cotton imports, depending on the relative availability of U.S. and foreign cotton. The TRQs are ordinarily relatively low, totaling about 250,000 bales, and have source- and quality-specific limits. But, when U.S. prices exceed world prices by a set amount, and some related conditions are met, new global quotas are added equal to the current rate of cotton consumption in the United States. During late 1995/96 and early 1996/97, the United States imported over 800,000 bales of cotton, compared with an annual average of 8,000 bales during the previous decade. However, even then, TRQ levels were millions of bales above actual imports since foreign prices were only briefly low enough to offset the non-price advantages of U.S. cotton.

U.S. Cotton Trade with the Western Hemisphere

The United States exports far more cotton to Western Hemisphere markets than it imports. As much as one-third of U.S. exports 2.6 million bales in 1997/98 are shipped to Latin America and Canada, while imports are typically less than 10,000 bales. However, during 1995/96 through 1996/97, the United States imported more than 300,000 bales from elsewhere in the hemisphere. Argentina was the world's second largest supplier to the United States during that time, accounting for nearly one-third of all U.S. imports. Argentina is the nearest large Southern Hemisphere

cotton producer, benefiting from counter-cyclical price seasonality with respect to the United States and relative proximity. In 1995/96, large exports after harvest ensured the United States remained a net exporter despite higher than normal imports.

U.S. exports to the Western Hemisphere have primarily been to Mexico, Brazil, and Canada. However, exports to other countries in the region surged during the 1990s as economic liberalization reduced trade barriers and their cotton production fell. Mexico became the leading destination for U.S. cotton exports due to NAFTA's effect on Mexican agricultural policy, textile trade, and U.S. foreign direct investment in Mexico. U.S. cotton exports to Canada have also increased since NAFTA took effect, rebounding from declines during the 1980s and early 1990s. The earlier FTA between Canada and the United States had little impact on cotton exports; it took the addition of Mexico to the pact to alter textile competitiveness and investment in favor of additional Canadian cotton use.

Brazil is the other primary market, importing as much as 337,000 bales from the United States. Brazil switched from an exporter to an importer during the 1990s as import tariffs on cotton fell from 10 percent to zero, and farm credit support dwindled. More recently, MERCOSUR'S Common External Tariff (CET) has risen to 6 percent, the effectiveness of government support for cotton producers has improved, and cotton production has adjusted geographically and technologically to achieve lower costs. Furthermore, Argentina's economic liberalization has spurred agricultural investment. MERCOSUR'S preferential tariffs and Argentina's proximity have helped keep U.S. shipments to Brazil below 300,000 bales in recent years.

U.S. shipments to former raw cotton competitors in South and Central America have soared from negligible levels at the beginning of the 1990s to several hundred thousand bales. Cotton production fell and imports rose in Colombia, Guatemala, and other countries as liberalization allowed their economies to shift resources to more competitive sectors of the economy. While the United States accounts for virtually all of Mexico's and Canada's cotton imports, its share of the rest of the hemisphere's net imports has averaged about 60 percent in recent years. While cotton production has virtually disappeared in Central America, many South American countries continue to produce and export cotton as well as import it. Excluding Argentina, which exports virtually all of its large crop, South American production equals about half of its consumption.

Possible Impacts of a Free Trade Area of the Americas on the U.S. Cotton Industry

The impact of an FTAA on U.S. cotton would be relatively small, regardless of whether the United States was a member. Import tariffs on cotton imposed by U.S. trading partners in the

hemisphere have been relatively low since the widespread economic liberalization. Marginally higher U.S. exports could result from an agreement that includes the United States. U.S. imports would probably change far less than exports since the U.S. marketing loan program as currently authorized ensures TRQ levels will exceed occasional, seasonal import needs so the absence of TRQ limits for the Western Hemisphere would have little effect. An FTAA without the United States would probably have an even smaller effect on exports.

The FTAA CGE model used to derive most of the results in this report (but not used in the cotton analysis due to aggregation in the model) assumes tariff reductions consistent with full WTO implementation, but excludes implementation of WTO non-tariff barriers. This is particularly important for textile trade due to import quotas developed under the Multi-fibre Arrangement (MFA) that remain largely in effect through 2005. Through NAFTA, Mexico has effectively had most of its textile exports to the United States free of quota, and Mexican textile exports have surged, as have Mexican cotton consumption and imports.

Legislative efforts to have the United States extend such access--or provide "NAFTA parity"--to the CBI countries have proven contentious in recent years, so it is important to note that this FTAA analysis is confined to the effect of tariffs. While non-tariff measures applied among potential FTAA participants do not necessarily hinder trade to a great degree, they may nonetheless preclude the kind of rapid growth in trade and investment observed in North America since the implementation of NAFTA. Distance is also a factor, so the repetition of structural textile industry shifts among FTAA participants comparable to those observed in North America in recent years would be far less likely, even with changes in textile quotas.

Rough estimates of likely FTAA tariff reduction impacts on cotton can be illustrated using: 1) results for competing crop prices, 2) average regional and U.S. tariffs for cotton and textiles, and 3) a range of elasticity estimates drawn from the agricultural economics literature. Reduced cotton import tariffs in U.S. Western Hemisphere markets could raise U.S. exports slightly. Reduced textile tariffs in the United States for Western Hemisphere exporters could raise U.S. imports of cotton textiles slightly, and further increase U.S. raw cotton exports.

U.S. import tariffs for in-quota cotton range from 1.5 to 4.4 cents per kilogram, or between 1 and 3 percent, depending on prices. Because raw cotton imports are such a negligible share of U.S. consumption, removing these tariffs for Western Hemisphere exporters would have little effect on cotton prices, consumption, or trade. Tariffs for raw cotton in other major Western Hemisphere markets range between 5 and 10 percent. Because about half of Brazil's and Colombia's cotton consumption is imported (and 70 percent of the hemisphere's non-North American consumption occurs there), the price of cotton to mills in the

region could decline by one half of the decline in the tariff. Given an own-price elasticity range of 0.3 to 0.5, the change in raw cotton tariffs could raise consumption 50,000 to 100,000 bales. Some of this would come from increased U.S. exports. With negligible changes in competing crop prices resulting from an FTAA in the model, the small decline in cotton prices would be the sole, negligible, effect on cotton production in the region. If the United States is not included in an FTAA, the effect of the agreement on cotton exports would be confined to this 50,000-to 100,000-bale increase.

Tariffs on apparel are higher than those for raw cotton, and increased derived demand for raw cotton would be expected if lower tariffs reduced the price of apparel in the Western Hemisphere. MERCOSUR'S and the Andean Community's apparel CETs are 20 percent, and U.S. apparel tariffs will be a trade-weighted average of 17.5 percent in 2004. Therefore, removing these tariffs could increase opportunities for trade in each direction, although the impacts would probably be larger in the United States. Since the United States' largest trading partners in cotton textiles are largely net exporters, the elimination of their tariffs would have smaller impacts on textile prices in their countries.

About one-third of U.S. textile and apparel imports (measured by fiber volume) made from cotton are imported from non-NAFTA Western Hemisphere trade partners. This is equal to about 20 percent of cotton products purchased by U.S. consumers. If U.S. tariffs on textile imports from these countries were eliminated, trade volumes and competitor prices remained unchanged, and the tariff changes were fully passed through to consumers, the removal of a 17.5-percent tariff could cause prices of U.S. cotton textile products to fall 3 percent. Assuming an own-price elasticity range of 0.3 to 0.5 for textiles, U.S. consumption would be expected to rise 0.9 to 1.5 percent, or 150,00 to 250,000 bales, before adjusting cotton prices for this increased demand. Equilibrium would be reached with a slightly higher cotton price, and a slightly lower increase in consumption. Also, because some of the affected imports are apparel produced from U.S. yarn or fabric, the tariff change would have an even smaller final impact on prices and consumption.

Because U.S. textile tariff reductions would be confined to Western Hemisphere countries, the increased use of raw cotton to produce textiles would also be confined to Western Hemisphere countries. U.S. raw cotton consumption would be unlikely to rise, but U.S. exports to other countries would rise.

The above estimates of an FTAA tariff change effects have assumed complete pass-through of reduced import costs. However, complete pass-through is unlikely, so the estimates may be regarded as upward bounds on the static impacts of an FTAA on cotton. The lower range of the initial estimates made above suggests world cotton consumption could be 200,000 bales higher due to an FTAA,

a .02-percent increase. U.S. exports could be 50,000 bales higher than with no agreement if the United States is excluded, or 100,000 bales higher if the United States is included, or 1 to 2 percent higher due to an FTAA.

Soybeans and Soybean Products

Current U.S. Policy

The United States already imports soybeans duty-free. U.S. imports of soybean meal have a \$5.30 per ton most favored nation (MFN) tariff and soybean oil imports have a 20.2-percent ad valorem MFN tariff. Neither tariff is imposed on imports from members of NAFTA, CARICOM, and the Andean Group. There are no quantitative restrictions of any kind.

U.S. Soybean and Products Trade with the Americas

U.S. soybean exports to the Western Hemisphere in 1997, valued at \$1.4 billion, accounted for 19 percent of all U.S. soybean exports. Nearly 80 percent of the hemisphere's soybean imports are by Mexico. With NAFTA, the United States has already received preferential access to Mexican markets. In 1997, Mexico imported 2.9 million tons of U.S. soybeans. The next largest importers were Brazil, Argentina, Venezuela, Canada, Costa Rica, and Colombia. Brazilian crushers can import soybeans duty-free (usually from Paraguay and the United States) under a drawback provision that stipulates an equivalent volume of meal and oil be re-exported within 90 days. A serious drought in 1997 compelled Argentine crushers to import U.S. soybeans for the first time last winter.

Many of the hemisphere's smaller or less developed nations cannot support their own soybean crushing facilities and instead import soybean meal and soybean oil. In 1997, U.S. meal trade in the region was valued at \$660 million, and oil trade at \$171 million. The leading importers of U.S. soybean meal in the hemisphere were Canada, Venezuela, the Dominican Republic, and Colombia. Major U.S. soybean oil importers included Mexico, Canada, Peru, Haiti, and Colombia.

The United States normally imports only 0.2 percent of its supplies of soybeans, soybean meal, and soybean oil, with virtually all of these from Canada. However, unusually acute shortages in the summer of 1997 nearly doubled U.S. soybean imports and prompted the first shipments ever from Brazil.

Possible Impacts of a Free Trade Area of the Americas on Trade in the Soybean Complex

Most nations have minimal duties on soybean imports. Although the dominance of U.S. soybean exports to Colombia and Venezuela would likely continue, a U.S. presence within an FTAA framework would inhibit any potential erosion of market share. However, an FTAA

that excluded the United States would tip the export competition more in favor of Brazil and Argentina, which would gain phased-in tariff preferences after the MERCOSUR merger with the Andean Group.

Changes in trade patterns for soybean meal and oil are more likely, which would in turn have significant effects on soybean trade. The elimination of tariff protection for soybean products would make it difficult for crushing plants to remain profitable in countries with comparatively little domestic soybean production, such as Colombia, Venezuela, Trinidad, and Costa Rica. On the other hand, a reduction in duties on meat could expand U.S. poultry and pork exports, which would curtail total consumption and imports of soybean meal in several nations. Typically, a portion of the vegetable oil and protein meal imports for several Central American nations are U.S. donations under the P.L. 480 program, and would be little affected by changes in tariff structure. A hemispheric trade agreement is unlikely to affect U.S. imports of soybeans or soybean meal.

Reduction of CARICOM's high (40 percent) external tariff on soybean oil would permit wider access to these markets. Brazil and Argentina, like the United States, have been blocked from exporting soybean oil to Europe and Asia by protective tariffs. As a consequence of this trade distortion, U.S. inclusion within an FTAA would cut U.S. tariffs for two efficient competitors and at times may allow modest increases in U.S. soybean oil imports.

Beef and Veal

Current U.S. Policies

Imports of beef and veal into the United States from countries other than Canada and Mexico are covered under a tariff-rate quota (TRQ), with an "in-quota" tariff rate of \$44.00 per metric ton and an "over-quota" tariff rate of 28 percent for 1998. U.S. beef and veal trade is also limited by sanitary regulations which stipulate that fresh, chilled, and frozen product may be imported only from areas that are certified as free of foot and mouth disease. Beef and veal imports from other areas must be cooked and sealed in an airtight container. Much of South America--with the exception of Chile, Uruguay, and Argentina--is considered foot and mouth disease endemic, and therefore cannot export uncooked beef and veal to the United States. The United States provides the following "in-quota" TRQ allocations for fresh, chilled, and frozen beef from foot and mouth free regions (table 5). Imports from Central America are included in the "other countries" category.

U.S. Beef and Trade with the Americas

The United States is a major trader of beef and veal with the Western Hemisphere but most of that trade is with Canada and Mexico. In 1997, U.S. beef and veal exports to the Western

Hemisphere were worth \$640 million, about 30 percent of total U.S. beef and veal exports. The NAFTA countries purchased almost 29 percent of all U.S. exports, with the rest of the hemisphere taking just over 1 percent of the total. After NAFTA, Brazil is the largest Western Hemisphere market for U.S. beef, followed by Bermuda. Caribbean countries import U.S. beef primarily for use by hotels and restaurants.

U.S. beef and veal imports from the Western Hemisphere accounted for about 50 percent of total imports or \$920 million in 1997. Imports from outside NAFTA represented about 14 percent of U.S. imports. The primary non-NAFTA suppliers are Argentina, Uruguay, and Brazil. Product from Brazil must be cooked and sealed in airtight containers, which limits this trade to thermo-processed products, primarily corned beef. Uruguay and Costa Rica are the two largest suppliers of uncooked beef from Central and South America, but it is likely that as Argentina expands production over the next few years, exports to the United States will reach their quota limits.

Impacts of a Free Trade Area of the Americas on Beef Trade

An FTAA encompassing all of the Western Hemisphere would likely change the source of beef and veal entering the United States, but not necessarily the total quantities. Under the terms of the Uruguay Round of the GATT, a number of Western Hemisphere countries were granted access to the U.S. market. Argentina and Uruguay were each explicitly granted a TRQ of 20,000 metric tons for low-duty access to the U.S. market. "Other countries" were granted a low-duty TRQ of 64,805 tons to ensure continued market access for undesignated historical suppliers, including the Central American countries. The TRQ for "other countries" was not filled in 1995-1997, indicating that increasing market access for those countries probably would not result in a significant influx of beef from Central America.

The removal of TRQ restrictions (over-quota tariffs) on beef from Argentina and Uruguay could lead to an expansion of U.S. imports from those countries, but not necessarily an increase in total U.S. imports. U.S. grading standards are such that imports from Argentina and Uruguay most likely would compete in the manufacturing beef market, which is dominated by Australia, New Zealand, and Canada, rather than in the higher-valued market for table cuts. Unit values for U.S. beef imports by source for 1997 indicate that beef from Uruguay is valued slightly higher than beef from Oceania but below that from Canada, suggesting that Uruguayan beef is competitive in the manufacturing beef market. Unit values of product from Argentina are slightly higher than those from Canada, indicating that a proportion of Argentine meat is being marketed as table cuts.

However, the amounts of product imported in 1997 and thus far in 1998 have been small relative to the available quota and it is possible that the proportion of table cuts may fall as imports

increase. Expanded beef imports from Argentina and Uruguay under an FTAA could potentially displace some product from Australia and New Zealand. This could drive down the price of beef from Australia and New Zealand or cause friction points elsewhere in the world as Australia competes with the United States in Pacific Rim beef markets.

The United States could expand beef exports slightly under an FTAA, but gains would likely be limited by the availability of lower cost, grass-fed beef from elsewhere in the hemisphere. Based on UN trade statistics, the United States supplied about 4 percent of non-NAFTA Western Hemisphere imports in 1993-95. The United States tends to export a higher quality grain-fed beef which commands a higher price and is generally used by the hotel and restaurant industry, which is highly income-sensitive. If an FTAA increases incomes in the hemisphere, opportunities may exist to increase exports and serve an expanding market through large supermarket chains.

Pork

Current U.S. Policies

Most major categories of pork enter the United States duty-free, but the United States restricts the import of pork from regions where foot and mouth disease or swine fever is present. This regulation excludes the vast majority of Latin America as a source of pork. However, the Mexican state of Sonora has recently been recognized as free of hog cholera and can ship pork to the United States.

U.S. Pork and Trade with the Western Hemisphere

U.S. pork exports to the Western Hemisphere represented about 19 percent of U.S. pork exports or about \$198 million in 1997. Mexico and Canada are the largest markets, averaging almost \$150 million in 1996-97, while U.S. pork exports to the rest of the hemisphere averaged about \$21 million during that period. Venezuela and the Caribbean islands are the largest non-NAFTA destination for U.S. pork in the region, where, as for beef, U.S. exports primarily serve the hotel and restaurant sector.

Currently, the United States imports only very small quantities of pork from Latin America. Imports from the Western Hemisphere were valued at about \$486 million in 1997. Although those imports represent more than half of all U.S. pork imports, less than 1 percent enters from sources other than Canada, primarily because of health restrictions.

Effects of a Free Trade Area of the Americas on Pork Trade

It is unlikely that an FTAA would have a more than a marginal impact on U.S. pork imports from the Western Hemisphere. Trade is greatly influenced by health restrictions and increased access is

based on appropriate sanitary and phytosanitary measures already subject to WTO rules. The two largest hemispheric traders with the United States are already allowed free access under the NAFTA.

The United States could expand pork exports slightly but gains would have to concentrate on a two-segment approach to marketing. U.S. exports of higher-priced cuts would be geared to the hotel and restaurant industry and larger supermarket chains, sectors that are highly income-sensitive. If an FTAA increases incomes, opportunities could exist to increase exports but they would depend on the degree to which other countries, primarily Brazil, could market lower-cost product within South America. Opportunities could exist for increased sales of trimmings for use in low-cost sausage products, but as with the higher-priced cuts it is probable that Brazil may be able to provide a competitive product.

Poultry

Current U.S. Policies

The United States has tariffs ranging from 9.5 cents per kg for uncut poultry to 19.1 cents per kg for poultry cut into pieces. The United States restricts entry of poultry products from most Western Hemisphere countries due to the incidence of Newcastle disease in all countries but Canada, Costa Rica, and Chile. Products from Costa Rica and Chile are not allowed access because their meat inspection systems have not been confirmed "equivalent" to the U.S. system.

U.S. Poultry and Trade with the Western Hemisphere

U.S. poultry meat exports to the Western Hemisphere represented about 22 percent, by weight, of total U.S. poultry meat exports in 1996-97. The value of U.S. exports to the Western Hemisphere equaled \$545 million in 1996. Mexico and Canada are the largest destinations. Exports outside of the NAFTA region were about \$140 million in 1996-97. The Caribbean region is the largest non-NAFTA destination and Colombia is the largest single non-NAFTA Latin American importer of U.S. poultry.

The United States imports only very small quantities of poultry from any source. Total poultry meat imports averaged \$19 million in 1996-97 and of that, just under \$17 million were from Canada. Disease restrictions and meat inspection standards limit potential suppliers to only a few countries.

Impacts of a Free Trade Area of the Americas on Poultry Trade

It is unlikely that an FTAA would have any impact on U.S. poultry meat imports. Trade is greatly influenced by health restrictions and increased access based on appropriate sanitary and phytosanitary measures is already subject to WTO rules. It is

unlikely that an FTAA would expand sanitary regulations.

There are opportunities for the United States to increase sales, especially of lower-value leg quarters to a number of markets in the Western Hemisphere. Excluding sales to NAFTA countries, U.S. exports represented 35 percent of Western Hemisphere imports in 1993-95. Although these markets are small, there would be opportunities to export low-cost poultry meat, especially to Central America and potentially Colombia. Exports further south may be limited by competition from the Brazilian poultry industry. Brazil, while having a competitive industry, lacks the markets to compete as effectively with low-priced cuts from the United States but may have a locational advantage in markets such as Argentina.

Dairy

Current U.S. Trade Policies

The United States maintains a series of tariff-rate quotas (TRQs) on a variety of dairy products. The quotas are allocated among a number of countries, largely based on historic shares. Canada and Argentina have the largest share among Western Hemisphere exporters, but there are also small allocations for several other hemispheric traders and a significant "any country" category. The TRQ allows imports up to the quota level at a low duty and then sets higher rates on quantities over the quota level. The United States established TRQs that will equal 141,000 tons for cheese, 22,785 tons for milkfat solids, and 26,825 tons for skim solids by 2000. Tariffs on these products will decline to 122.7 cents/kg for cheese, 154.1 cents/kg for butter, and 86.5 cents/kg for nonfat dry milk.

The United States uses Dairy Export Incentive Program (DEIP) funds to expand exports in a number of markets. Under the terms of the Uruguay Round Agreement, by 2000 the United States would be allowed to subsidize a maximum of 3,000 tons of cheese, 21,000 tons of butter/oil, 68,000 tons of non-fat dry milk, and 34 tons of other dairy. Maximum expenditures to subsidize each commodity cannot exceed \$3.6 million, \$30.5 million, \$82.5 million, and \$21,000 respectively.

U.S. Dairy and Trade with the Western Hemisphere

The value of U.S. dairy exports to the Western Hemisphere averaged about 43 percent of total exports or \$360 million in 1996-97. Of that, approximately \$260 million were to Canada and Mexico. Despite the NAFTA, the United States lacks free access to either Canada or Mexico, but will have free trade with Mexico. In both countries, TRQs are in place with over-quota tariffs that effectively preclude additional exports. In the case of Mexico, the TRQ extends only to non-fat dry milk (NDM). In Canada the TRQs cover all dairy commodities. The bulk of non-NAFTA exports to the Western Hemisphere goes to the Dominican Republic, Brazil,

and Colombia. The majority of exports to the Western Hemisphere consist of so-called "soft products," such as yogurt, ice cream, and whey. Mexico and Canada are the largest destinations for these products. Cheese is also exported to Central and South America. Mexico is, at times, a major market for NDM although sales often depend on the level of DEIP support available.

The United States imports a considerably smaller volume of dairy products from the Western Hemisphere. Imports in 1996-97 averaged \$135 million, 11 percent of total dairy imports. Canada and Mexico were the primary sources, averaging \$106 million, but in 1997 imports from Argentina expanded dramatically and Argentina supplanted Mexico as the second largest supplier from the region. Nonetheless, imports from Argentina in that year totaled only \$23 million. Imports from the Western Hemisphere consist primarily of cheese and soft products.

Impacts of a Free Trade Area of the Americas On Dairy Trade

Barring changes in the conditions agreed to in the CFTA/NAFTA and the Uruguay Round, U.S. access to Canadian dairy markets will remain limited. Some expansion in exports to markets in Central America is possible if tariffs are eliminated. Exports to Brazil, the hemisphere's largest importer, could increase if the United States received the same preferential access accorded to Argentina. Under the rules of MERCOSUR, Argentina has free access into the Brazilian market. As result, Argentina has seen its market share rise sharply while the U.S. share of Brazil's imports averaged 2 percent in 1993-95. However, if U.S. exports displace those from Argentina, U.S. imports from Argentina could expand.

Sugar

Current U.S. Sugar Policy

While separate from the domestic sugar price support program, the tariff-rate quotas (TRQs) for sugar and sugar-containing products are a key component of U.S. sugar policy. The TRQ for raw cane sugar is currently allocated to 40 countries by the U.S. Trade Representative, and in 1997/98 was established at 1.6 million metric tons, well above the WTO minimum access of 1.1 million tons. Because the U.S. sugar price is significantly higher than the world price, the TRQs are generally nearly fully subscribed. Under the Uruguay Round Agreement, the U.S. second-tier tariff on raw sugar will decline over 6 years to 15.36 cents a pound by fiscal year 2000, a level likely to continue to limit imports.

The refined sugar TRQ is established at 50,000 metric tons, including Mexico's 25,000 tons of NAFTA access which can be shipped as raw or refined sugar. The remaining 25,000 tons are allocated as follows: 10,300 tons to Canada; 2,954 tons to Mexico; 7,090 tons on a first come, first served basis; and 4,656 tons to specialty sugar, also on a first come, first served

basis. Following 1997 discussions between Canada and the United States concerning trade in sugar and sugar-containing products, the United States began allocating the refined TRQ on the basis of historical access. Canada's exports of refined sugar to the United States dropped in fiscal 1996 when the United States established the refined sugar TRQ at 22,000 tons as a result of the Uruguay Round. Sugar exports from Canada to the United States are currently subject to most favored nation (MFN) rates, as NAFTA sugar provisions do not apply to trade between the United States and Canada.

Under NAFTA, Mexico's zero-duty access to the U.S. market is limited to the amount of "net surplus" sugar (excess of domestic sugar production over consumption of sugar and high fructose corn syrup), but not more than 25,000 tons until fiscal 2000. In 1996/97, 1997/98, and 1998/99, Mexico achieved "net surplus" status and was granted 25,000 tons duty-free access to the United States. Maximum access will increase to 250,000 tons until 2008. After 2008, trade between Mexico and the United States will be unrestricted. Because the prices for raw and refined sugar will be similar in both countries, it is possible that the U.S. refining industry will be in a position to supply some of Mexico's refined sugar needs.

Most members of the Caribbean Basin Initiative (CBI) and the Andean Group receive allocations under the raw cane sugar TRQ and are granted preferential low-tier tariffs on TRQ imports. The preferential tariff rates are granted under the Generalized System of Preferences.

U.S. Sugar Trade Within the Western Hemisphere

The United States allocates 66 percent of the raw cane sugar TRQ to 22 countries in the Western Hemisphere: 14 CBI countries (includes all countries in Central America), 4 Andean Group countries, and 4 others in South America. All of these countries receive preferential tariff treatment except Brazil. U.S. raw sugar imports under the TRQ were about 1.2 million tons per year in 1992/93-1994/95, then almost doubled to over 2 million tons in 1995/96 and 1996/97. At that TRQ level, imports from Western Hemisphere countries were around 1.4 million tons.

The United States also operates a sugar re-export program, under which U.S. refiners may import world-priced raw sugar if they re-export a like amount of refined sugar or transfer world-priced sugar to sugar-containing product manufacturers who must in turn export a like amount of sugar in sugar-containing products. Annual U.S. imports and exports under this program were around 500,000 tons in 1995/96 and 1996/97. U.S. refiners export about 150,000 tons of refined sugar per year to Western Hemisphere countries for industries that require highly refined sugar, like the tourist and soft drink industries of the Caribbean.

Impacts of a Free Trade Area of the Americas on the U.S. Sugar

Industry

Within an FTAA, the price of sugar could either be supported with border measures, or left free to adjust to world prices. Continuance of border measures between members of an FTAA is not contemplated. Due to the dominance of Brazil, it is assumed that sugar prices in countries that currently support sugar production would decline. While many Western Hemisphere countries maintain internal sugar prices above the current world price, Brazil does not. Brazil has 85 percent of Latin American exports, 44 percent of Western Hemisphere exports, is the largest producer and exporter in the world, and is expanding production rapidly. Consequently, in an FTAA domestic sugar prices would probably fall to a level equivalent to the Brazilian price plus transportation costs. Similarly, Brazilian prices would increase due to rising demand.

If the United States participated in an FTAA with full trade liberalization, it is likely that the U.S. price of sugar would decline, U.S. sugar production would decline, and imports would rise. Additionally, at current loan rates, forfeitures of sugar to the Commodity Credit Corporation could be expanded dramatically, making the U.S. government a significant buyer of U.S. sugar. The current TRQ allocations would not likely be consistent with the FTAA and the U.S. Trade Representative would probably have to develop a new allocation procedure. U.S. imports from Africa and Asia would be expected to decline, while imports from Western Hemisphere sources would rise, particularly from low-cost exporters such as Brazil and Guatemala. U.S. industrial users would gain from the lower price.

If the United States were not part of the FTAA (at least with regard to sugar), Mexico would also have to not participate, or the NAFTA sugar provisions would have to be revised. Under NAFTA, the U.S. and Mexican sugar markets will be unified by the year 2008, and it would not be possible to maintain different prices. If the United States and Mexico both did not participate, it might be possible for the current U.S. (NAFTA) sugar price support program to continue, in which case there would be minimal impact on the U.S. sugar industry. There are no current prospects for convergence of the U.S. and Canadian sugar markets, so it would make no difference if Canada was in or out of the FTAA with regard to sugar.

Many CBI countries, and some in Central and South America, depend heavily upon receipts from the high-priced U.S. market. With the loss of a premium export market and/or lower prices internally, sugar production in many countries would decline. Some low-cost producers such as Brazil and Guatemala would expand production. Overall, it is likely that hemispheric production would decline slightly, in which case the world price would rise marginally. Sugar consumption responses to price changes are generally small, but demand would rise due to lower prices in most countries except Brazil.

Orange Juice

Current U.S. Policy

The United States has a most favored nation (MFN) tariff of 8.32 cents per liter on frozen concentrated orange juice (FCOJ). Under the Uruguay Round agriculture agreement, the orange juice tariff rate declines 15 percent over 6 years from the initial 9.25 cents per liter to 7.85 cents per liter by the year 2000.

Under NAFTA, Mexico has access to the U.S. market for 40 million gallons (single-strength equivalent (SSE)) of FCOJ at a duty of 4.625 cents per liter. Beyond the 40-million-gallon level, and up to 70 million gallons SSE, the full NAFTA rate for 1998 of 8.094 is applied. If snapback price conditions are not in effect, the NAFTA rate would continue to be applied beyond the 70-million-gallon level. However, if price conditions are in snapback, the full MFN rate currently, 8.32 cents per liter for 1998, would be assessed on all imported volumes beyond the 70-million-gallon threshold. This basic mechanism will remain in effect during the 15-year phase-in period agreed upon in the NAFTA negotiations, although the quantity trigger level will be increased to 90 million gallons SSE in year 2003.

A NAFTA TRQ is also in place for FCOJ. Under the TRQ, the higher MFN tariff will be reimposed if FCOJ daily average prices for 5 consecutive days fall below the previous 5-year average for that month and U.S. imports from Mexico exceed 70 million gallons between 1994 and 2002, and exceed 90 million gallons between 2003 and 2007.

There is no tariff for single-strength orange juice from the Caribbean Basin Initiative countries, Israel, Andean Trade Preference countries, and the tariff for Canada was eliminated in 1998. NAFTA includes a snapback provision with Canada to MFN rates until 2008. The tariff for single-strength orange juice from Mexico is one-half the MFN applied tariff with a tariff-rate quota of 4 million gallons. Any juice above this quantity will be assessed the current applied MFN of 5.3 cents per liter, to be phased out on a straight-line basis over 15 years. The in-quota tariff will remain unchanged until it equals the over-quota tariff (year 8), when it will be phased out at the same rate as the over-quota tariff.

Recent Trade Patterns

Orange juice trade between the United States and Latin America is mostly in one direction, with the United States importing from Brazil, Mexico, and to a lesser extent Belize, Honduras, and Costa Rica. Latin America imports very little orange juice, accounting for only 3 percent of U.S. orange juice exports in 1996/97.

Imports account for less than 20 percent of U.S. consumption during good crop years. Brazil accounts for about 60 percent of the imports. Orange juice from Brazil is used early in the juice-processing season to blend with Florida oranges to get the desired color and flavor blend. In recent years, several major orange juice processors located in Brazil have bought processing plants in Florida. These processors have invested in the Florida citrus industry to maintain a presence for Brazilian orange juice in the United States.

Brazilian orange juice also supplements Florida production during years when domestic output is low, such as in 1988 and 1989 when major freezes reduced the Florida orange crop. New groves were planted in southern Florida to replace those lost by the freezes. These trees have now begun bearing fruit and produced record crops in 1996/97 and 1997/98. With the reduced risk from freezing temperatures in southern Florida, prospects are for steadily increasing production. Demand for imported orange juice is expected to decline in response to Florida's increasing output. Along with the present tariff on imported orange juice is a drawback provision that allows importers to recover all but about 1 percent of the tariff's value if they export an equal amount of orange juice that has been modified.

Possible Impacts of Liberalization on U.S. Agriculture

With the removal of tariffs, there may be an incentive to import more inexpensive Brazilian orange juice, which may displace Florida juice. Over time, the large U.S. production is expected to lower U.S. orange juice prices, making it more competitive with Brazil. However, the higher cost of production in the United States will probably keep Florida's prices above Brazil's. Florida presently markets the bulk of its juice domestically with only minimal competition.

Lowering or reducing tariffs under an FTAA would have little effect on U.S. orange juice exports, which have grown in recent years as domestic demand has stabilized. U.S. orange juice is known for its high quality and exports can be expected to increase to the European Union, presently Brazil's largest market, and Japan. Exports to Latin America would probably be unaffected by a free trade agreement. Orange juice consumption in Latin American countries is mostly fresh squeezed and demand for FCOJ or pasteurized juice will probably not expand significantly, even with increased incomes in these countries.

Tobacco Leaf and Products

Current U.S. Policy

A tariff-rate quota (TRQ) is the only tobacco-specific policy that affects U.S. tobacco trade with other Western Hemisphere nations. The United States has maintained a TRQ scheme on flue-cured and burley tobacco since 1995, but imposes neither

quotas nor duties on cigar wrapper, binder, and filler, and Oriental tobacco. Tobacco products such as cigarettes and cigars do not fall under the tariff rate quota. The TRQ replaced a domestic content rule in place since 1994 (under which cigarettes manufactured in the United States had to contain 75 percent domestic leaf). This rule was determined to be inconsistent with the General Agreement on Tariffs and Trade (GATT). UR implementing legislation contained provisions ending the domestic content provisions. The TRQ stemmed from negotiations with supplier countries that established the GATT/WTO-consistent quotas. Under the TRQ, major suppliers of tobacco leaf have individual quotas based on historical trade patterns.

The TRQ applies only to the quantities imported for domestic consumption as most of the duty on imported tobacco used to manufacture cigarettes for export may be refunded. Imports above quota levels are subject to a 350-percent ad valorem duty. Because of superseding agreements, Canada, Mexico, and Israel are not included under the quantitative restrictions. The TRQ currently limits annual imports (year beginning September 13) under nine harmonized tariff subheadings to 26.5 million pounds for Argentina, 176.8 million pounds for Brazil, 6.1 million pounds for Chile, and 19.6 million pounds for Guatemala. Quotas for Argentina and Guatemala will increase slightly in the next 3 years.

The TRQ does not appear to provide much, if any, price enhancement for imported tobacco. Although Argentina and Chile shipped their full allotments during the first year the quotas were in place, Brazil, the major supplier, shipped only 68 percent of its allotment. Part of the reason for Brazil's shortfall may have been a poor season in that country.

Recent Trade Patterns

Recent trade patterns are characterized by leaf shipments from other Western Hemisphere nations to the United States and shipments of manufactured tobacco products, primarily cigarettes, from the United States to other Western Hemisphere nations. Western Hemisphere nations supplied 42 percent of U.S. tobacco leaf imports in 1997. Brazil supplied the largest share, with 22 percent of total imports. Argentina, the Dominican Republic, and Canada are also major suppliers. (Leaf shipments from the Dominican Republic are mostly cigar types not covered by the tariff-rate quota).

The United States is the major supplier of manufactured tobacco products for Western Hemisphere markets, with about 60 percent of their imports in 1996. In contrast, these markets account for only about 6 percent of total U.S. exports. Canada, Mexico, Brazil, Panama, Paraguay, Aruba, and the Netherlands Antilles are the major Western Hemisphere markets for U.S. manufactured tobacco product exports, primarily cigarettes.

The United States supplies about 20 percent (1993-95 average) of the tobacco leaf imported by Western Hemisphere nations. Much of this leaf goes to Caribbean nations. Western Hemisphere countries are far less important to the United States as a market for tobacco leaf than they are as a supplier. The United States shipped only 3 percent of its leaf exports to Western Hemisphere countries in 1996, while importing 37 percent of its leaf imports from Western Hemisphere countries.

Impacts of Liberalization on U.S. Agriculture

U.S. tobacco leaf imports would not likely change substantially under a hemispheric free trade agreement with full liberalization and in which the United States was a full participant. The current U.S. TRQ is not a very restrictive constraint on trade and relaxing quotas further would not likely cause much additional tobacco to enter the country.

U.S. leaf exports, on the other hand, would likely rise from current low levels, due to growing demand for high-quality cigarettes in South America. Because of increasing demand for quality, local manufacturers would import additional U.S. leaf to improve the quality of their cigarettes and remain competitive with U.S. cigarettes.

The United States will remain the major supplier of cigarettes to Western Hemisphere countries and may even increase its market share under full trade liberalization. U.S. cigarettes are considered a quality product in world markets, and gains in personal incomes from trade liberalization in other Western Hemisphere countries resulting from a free trade agreement would boost the demand for high quality cigarettes.

Other Western Hemisphere countries ship negligible quantities of cigarettes to the United States and will not appreciably expand their exports as a result of further trade liberalization. U.S. demand for imported cigarettes is very small due to the preference for the higher quality of U.S. cigarettes.

Under a hemispheric free trade agreement without U.S. participation, U.S. leaf trade would remain essentially unchanged as local cigarette manufacturers in other Western Hemisphere countries would continue to purchase U.S. leaf because of its high quality. The U.S. share of the cigarette market in Western Hemisphere countries also would remain relatively unchanged, as smokers continue to prefer the high quality and prestige associated with the U.S. product.

Peanuts and Peanut Paste

Current U.S. Policy

The U.S. peanut program is a two-tiered price support program under which all domestically produced peanuts are either quota

peanuts or additional peanuts. Quota peanuts may be marketed in an amount determined by the USDA to be sufficient to satisfy domestic food demand and planting seed requirements. Each season, prior to planting, USDA announces a national quota poundage that is then allocated among quota holders according to their historical proportion of quota production. Only quota peanuts may be marketed into domestic food channels. A separate quota is calculated for seed and allocated to all peanut producers in an amount equal to their planting seed use. Recipients of seed quota may market an amount of peanuts into the domestic food market equal to their seed quota. Additional peanuts may be marketed into the domestic food market as buybacks, but only if the purchaser pays the quota loan rate and storage and handling costs. Otherwise, additional peanuts must be marketed for domestic crushing or exported.

The price support is administered by a nonrecourse marketing loan. All U.S. peanut production is eligible for a marketing loan. The loan rate for quota peanuts is \$610 per short ton, in-shell, while the loan rate for additional peanuts is \$132 per short ton. The additional loan rate is set each year by USDA so as to minimize the potential for CCC loss associated with additional marketing loan activity. The quota loan rate is fixed for the duration of the 1996 Farm Act at \$610 per ton.

Under the 1996 Act, there is no longer a minimum national quota poundage and USDA may adjust the annual quota upward or downward to satisfy the demand for domestically produced food peanuts and seed requirements. The quota price support elevates the cost of domestically produced food peanuts well above the prevailing world market price. Additional peanuts are generally priced competitively on the world market. Each pound of peanut imports used in the domestic food market displaces a like quantity of quota production. In order to maintain the program and price support, the domestic market must be protected from much less expensive imports of raw peanuts and peanut butter and paste products.

Under NAFTA, the United States established a TRQ for Mexican peanuts (shelled and in-shell). The original quota was 3,377 metric tons with over-quota tariffs of about 123 percent for shelled peanuts and 186 percent for in-shell peanuts. The TRQ increases at 3 percent per year, and the over-quota duties are scheduled to decline 15 percent in the first 6 years and then be phased out by 2008 under the agreement. Peanut products imported from Mexico must be made from Mexican-grown peanuts to qualify for NAFTA benefits.

Under the Uruguay Round agreement of the GATT/WTO, the United States established a TRQ on peanut butter and peanut paste imports, with most allocated to Canada and Argentina. The Canadian portion of the TRQ is set at 14,500 tons. There is no constraint on peanut butter imports from Mexico, other than that peanut products must contain Mexican-grown peanuts only.

Recent Trade Patterns

U.S. peanut and peanut butter/paste imports are strictly controlled by law as to origin and quantity. From April 1996 to March 1997, the United States imported 74.5 million pounds (shelled) of peanuts. Argentina supplied 73 percent, Mexico supplied 12 percent, Nicaragua supplied 8 percent, and other countries, 7 percent. Imports were estimated at 2.9 percent of the total U.S. supply.

The United States traditionally dominates the world export market for peanuts, with annual exports in the range of 650-750 million pounds. However, Argentina is projected to become the world's largest exporter in 1997/98, surpassing the United States and China. Canada, the Netherlands, and the United Kingdom are the largest export markets for U.S. peanuts, taking about 20 percent, 15 percent, and 10 percent, respectively, of total U.S. exports in 1994-97.

Possible Impacts of Liberalization on U.S. Agriculture

The U.S. food market is very attractive to foreign peanut producers due to the high prevailing domestic peanut price. If TRQ protection were removed, a very large share of the U.S. food market would likely be captured by foreign peanuts and products. The USDA would have to reduce the national poundage quota proportionately to reflect the declining demand for domestically produced food peanuts. If the price support were maintained at \$610, the poundage quota would likely be nil and the current U.S. peanut program ineffective.

Complete liberalization of the U.S. peanut market within an FTAA would drive the domestic peanut price down toward world price levels, perhaps even raising the world price. U.S. demand for peanuts could expand by as much as 20-25 percent, and U.S. peanut production would likely become more concentrated in the Southwest producing area where most "additional" peanuts are grown. Certain geographic areas of the United States that produce "quota" peanuts, would face adjustments as high value quota peanut production is eliminated. While Georgia peanut production could contract, the infrastructure present will ensure continued production there. The United States would continue to be a competitive peanut producer even if the domestic price declines below the current high levels. U.S. peanut exports could actually increase slightly because of higher world prices. U.S. peanut yields and quality are among the highest in the world, and U.S. exports have an excellent reputation for dependable quality.

Some Concluding Observations

The Free Trade Agreement of the Americas (FTAA) is one of several trade agreements that the United States is pursuing. An FTAA that eliminates tariff barriers among the 34 Western Hemisphere

countries would benefit the U.S. economy as a whole and the U.S. agricultural sector in particular. However, the potential economic effects of an FTAA, with or without U.S. participation, would be relatively small in the short-run (3 to 5 years). The estimated gains to U.S. agriculture would accrue from increases in exports and incomes above projected baseline levels.

While the analysis accounts for most of the likely effects on the U.S. economy and agriculture, our highly stylized representation of the world does not deal with several issues.

- o Notably, the analysis assumes constant amounts of land, labor, and capital: the estimated gains come only from the reallocation of existing resources. In the longer run, an FTAA would stimulate the growth and efficiency of members' factors of production (e.g., a more skilled labor force). Another ERS study³ has shown that when capital investments and linkages between open trade and economic growth are taken into account, a hemispheric agreement would permit all countries, including the United States, to gain, regardless of whether the United States participates. For instance, U.S. agricultural exports would increase by 5.9 percent over the long run with participation in an FTAA and by 4.7 percent even without participation. This indicates that U.S. agricultural exports would increase 1.2 percent as a result of an FTAA.

- o Labor and employment issues often receive a great deal of attention during trade negotiations. Much of this attention revolves around the displacement of labor in particular sectors and the adjustment costs associated with the lack of mobility. Neither of these issues is directly addressed in the analytical framework, which assumes full employment and no adjustment costs. The study, therefore, may understate the costs associated with an FTAA. These costs, small as they may be, can have a significant bearing on trade negotiations, as was apparent during the NAFTA talks in which concerns about the employment impact of a fully opened Mexican corn market resulted in a TRQ on Mexican imports of U.S. corn.

- o Similarly, the findings on the economic consequences of regional integration are national or sectoral in nature and do not take into account the impacts on different types of farm households. How a farm household will fare following integration depends on its commodity exposure (what the farm can produce profitably) as well as its asset exposure (farm size, leverage, specificity and diversity of its assets). Indeed, the short-run adjustment costs for some farm households could be large. Hence, the debate on the acceptability of an FTAA may hinge on its distributional consequences rather than on the gains to the entire economy or to the agricultural sector as a whole.

- o Many of the current trade issues among countries in the Western Hemisphere concern food safety standards, state trading, and the environment. An FTAA accord, therefore, is likely to go

beyond simple tariff liberalization. The analysis takes into account some, but certainly not all, of the non-tariff barriers that restrict trade among countries of the Western Hemisphere. Hence the potential gains from an FTAA, especially in agriculture where non-tariff barriers are more prevalent than in other sectors, might be larger than the analysis indicates.

o The analysis centers around the potential economic effects of a trade agreement encompassing all countries in the Western Hemisphere. But there are several trade agreement negotiations in progress between hemispheric countries and those outside the region. For example, MERCOSUR and Mexico are negotiating a trade agreement with the European Union, while Canada recently initiated discussions with the European Free Trade Association. Side agreements between a hemispheric country and one outside the region may alter the stream of benefits from an FTAA. Similarly, the United States and other WTO members will participate in a new round of agricultural trade liberalization negotiations starting in 1999 that could dramatically alter the world trade environment well before FTAA implementation is completed. The results of our analysis, therefore, should be viewed as indicative of the likely effects of an FTAA rather than precise estimates of potential changes.

These are some of the elements outside the analysis that could affect the economic issues and options that are likely to impinge on the potential economic consequences of an FTAA. But at this stage there is not a strong sense of exactly how a hemispheric agreement would shape up. Even so, the basic conclusion--that an FTAA would bring modest benefits to the United States--would remain valid under almost any likely set of circumstances.

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