North American Agricultural Market Integration and Its Impact on the Food and Fiber System

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The Quest for More Integrated Markets

Agricultural markets in the United States, Canada, and Mexico have changed markedly within the last two decades as the food and fiber system in North America has become more economically unified. The U.S., Canadian, and Mexican agricultural economies function increasingly like a single market due to the passage of time and the interaction of domestic and continental forces of supply and demand. These market forces became less encumbered with the passage of the Canada-U.S. Free Trade Agreement (CUSTA) in 1989, the North American Free Trade Agreement (NAFTA) in 1994, and the Uruguay Round Agreement on Agriculture (URAA) in 1995. The movement toward a more integrated North American agricultural economy has enlarged the market for U.S., Canadian, and Mexican producers and has transmitted more accurate price signals across national borders, increasing economic activity and productivity. Information that better reflects consumer demand and producer supply has enabled specific commodity and product markets to function more efficiently and to grow more rapidly.

In more integrated markets, farmers specialize in production activities in which they are comparatively proficient, consumers pay lower prices for purchased goods, and society is better able to reap increasing returns from technological innovations and economies of scale. The benefits of integrated markets explain the creation of the European Union (EU), participation by many countries in regional trade agreements, and the genesis of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO).

The URAA established a framework of rules for agriculture, initiated reductions in tariff protection, curtailed trade-distorting domestic support, and imposed disciplines on export subsidies for the first time. The agreement lowered agricultural tariffs and promoted the conversion of quotas, licensing requirements, and other nontariff barriers into tariff equivalents for subsequent reduction and/or elimination. The URAA also established the WTO dispute settlement mechanism and imposed restrictions on domestic policies, limiting the amount of national support allowed. These reforms have enabled the global market to function more efficiently. Yet, artificial impediments to trade remain.

Agricultural protectionism continues to be a major problem worldwide (Gibson et al.). Trade is severely hampered by the use of policy instruments that impede trade, such as tariffs, domestic labeling requirements, national sanitary and phytosanitary regulations, antidumping rules, countervailing duties, commodity safeguards, and state-trading import regulations (USDA, ERS, May 2001). Given these practices, international negotiators must determine how to discipline their widespread use.

One possible solution is seen in the regional trade agreements (RTAs) that have recently become a fixture in the global trade arena (Burfisher and Jones). RTAs can be powerful forces promoting market liberalization that not only complement, but go beyond, multilateral trade efforts to open international markets (Bergsten). They are, in other words, viewed as vehicles to "deeper integration," where deeper integration is associated with the removal of "behind-the-border" barriers inhibiting trade. Not only is it easier to reach agreements on trade issues when negotiating with fewer countries under an RTA than with many more countries participating in the WTO, but it is easier to sustain national differences in cultural tastes, preferences, and institutions where openness and diversity are tolerated because of trust, mutual respect, and shared basic values.

Even so, RTAs often represent a second-best solution because they typically divert as well as create trade

(Bhagwati and Panagariya; Panagariya). Trade is created by the reduction of member-country trade barriers. Trade is diverted whenever member-country imports shift from more efficient nonmember suppliers to a less efficient member supplier due to RTA concessions. The question of trade creation versus trade diversion is "the single most interesting question related to regional agreements" (Gardner, 2000).

Empirical analyses show that the trade-creating effects of NAFTA have dominated the trade-diverting effects (Clausing; Vollrath, 1998). These empirical findings suggest that by lowering and removing border measures that constrain market forces, NAFTA has enlarged the open market in North America (USDA, ERS, 2002). NAFTA has also promoted North American agricultural market integration by extending national treatment to foreign-owned companies and increasing access by foreign companies to domestic financial markets. However, many institutional barriers continue to segment national markets in North America. Further integration of these markets could be achieved through harmonization of inspection, grading, and labeling standards; better coordination of domestic farm, marketing, and macroeconomic policies; and the adoption of a universal system of commercial law and common antitrust and regulatory procedures.

Creation of an environment conducive to spatial and temporal integration is more important than ever in the modern world because the impact of open-market reforms has become more pronounced with the advent of the new information technologies (IT). Advances in electronic telecommunication and use of the Internet enable communication to take place faster and cheaper than ever before in openly integrated markets. Communication networks allow individuals, companies, and communities to interact more effectively with each other across national borders and to reap the benefits of increasing returns. The IT revolution is likely to fuel economic growth by lowering costs (Friedman, 2000).