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NAFTA and U.S.-Mexico Cattle Trade

(name redacted)

Specialist in International Trade and Finance
Environment and Natural Resources Policy Division

Summary

The North American Free Trade Agreement (NAFTA) was implemented in January 1994. Thus far, no clear pattern has emerged regarding U.S.-Mexico cattle trade: in the first year the U.S. trade deficit in cattle fell, but in the second year that deficit reached a record level. While some U.S. cattle producers blamed NAFTA for the record deficit, the underlying causes were devaluation of the peso, Mexico's economic contraction, and drought in northern Mexico. Lower U.S. cattle prices, which some also contend were the result of NAFTA, were the result of several factors including high grain prices and large domestic cattle supplies.

Introduction

During 1995, U.S. cattle imports from Mexico surged in value by 54% from the year earlier. Over the same time, U.S. exports fell to an almost negligible level. Many cattle producers in the United States blamed the recently implemented NAFTA for the dramatic change. Cattle imports from Mexico were about 1% of the total U.S. herd; feeder cattle imports represented 4-5% of all U.S. feeder cattle.

U.S.-Mexico Trade in Cattle

Figure 1 on the following page shows U.S. imports and exports for 1991-1995. This period includes the three years preceding NAFTA implementation (on January 1, 1994) and the two years since. The data show that both before and after NAFTA, U.S. imports of cattle from Mexico were much greater than U.S. exports. In the first year of NAFTA (1994), U.S. imports of cattle from Mexico fell from the prior year and U.S. exports grew, causing the U.S. deficit in cattle to fall below the deficit in the three pre-NAFTA years. In the second year of NAFTA (1995), however, that pattern changed. U.S. imports of cattle shot up and exports nearly disappeared, causing a record U.S. bilateral trade deficit in cattle.

Figure 1

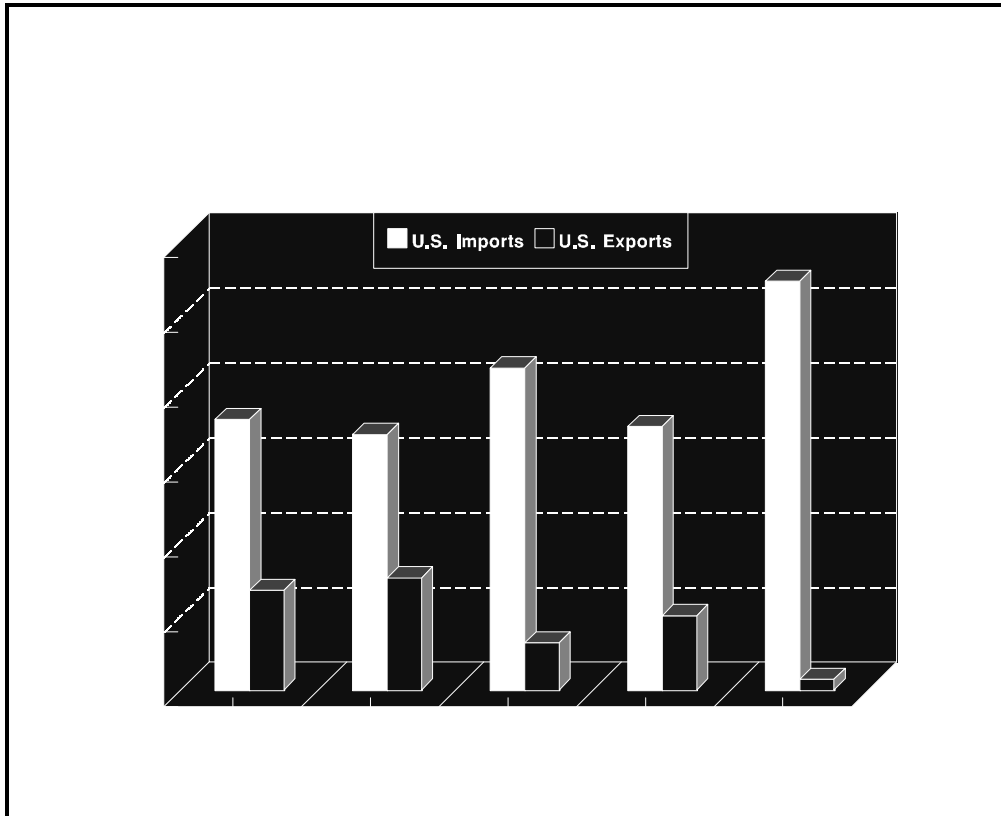


Table U.S.-Mexico Trade in Cattle and Calves

Cattle	1991	1992	1993	1994	1995
<i>Quantity, Thousands</i>					
U.S. Imports	1,034.2	982.0	1,296.6	1,072.1	1,653.4
U.S. Exports	210.1	251.5	76.9	128.6	14.6
<i>Value, \$ Millions</i>					
U.S. Imports	\$361.0	\$341.2	\$429.8	\$351.9	\$545.7
U.S. Exports	\$132.9	\$149.6	\$62.6	\$98.9	\$13.9

Source: USDA. Foreign Agricultural Trade of the United States.

In considering bilateral trade in cattle, however, it is important to be aware that the United States and Mexico have a highly complementary trading relationship. Mexico sends its cattle to the United States for processing, and the United States ships back beef. Figure 2 on the next page shows that almost all beef that is shipped between the two countries goes from the United States to Mexico.

Figure 2

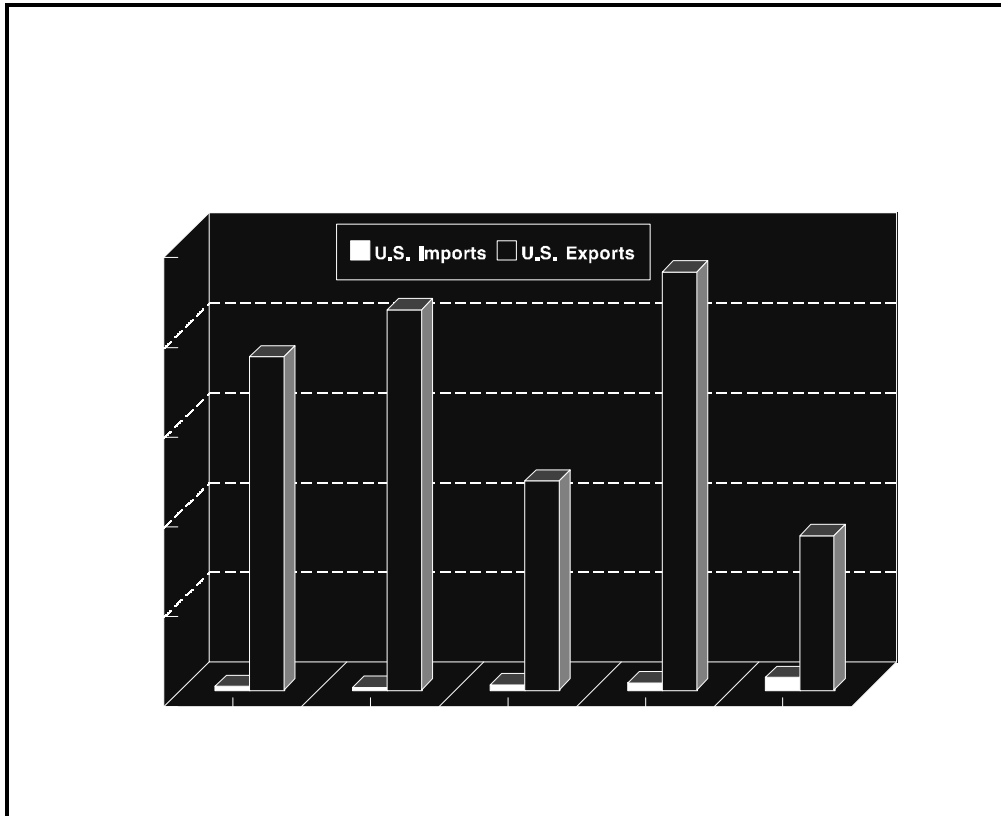


Table U.S.-Mexico Trade in Beef and Veal

Beef and Veal	1991	1992	1993	1994	1995
<i>Metric Tons thousands</i>					
U.S. Imports	561	299	1,091	1,257	2,101
U.S. Exports	64,234	69,152	39,444	72,340	29,219
<i>Value, \$ Million</i>					
U.S. Imports	\$1.9	\$1.4	\$2.7	\$3.9	\$6.8
U.S. Exports	\$185.4	\$211.6	\$116.3	\$232.5	\$85.8

Source: USDA. Foreign Agricultural Trade of the United States.

Factors Affecting Cattle Trade

Why did U.S. cattle imports from Mexico rise so much in 1995, and why did U.S. exports fall so much? The three chief reasons were: (1) peso devaluation; (2) economic contraction in Mexico; and (3) drought in northern Mexico.

Peso Devaluation

On December 20, 1994, the Mexican government devalued the peso by 15%. In succeeding days, the peso swiftly floated downward for a total drop of 40% in value.¹ The drop in the peso's value was followed by other serious economic problems, including higher inflation and a deep depression. By the summer of 1995, the United States and international financial organizations had extended assistance to Mexico to help stabilize its economy.

The peso devaluation has several implications for U.S. agricultural and other trade. The devaluation caused U.S. exports, which are denominated in dollars, to become relatively more expensive in the Mexican market, and caused Mexican exports, which are denominated in pesos, to become relatively less expensive in the U.S. market. Thus, U.S. cattle exports to Mexico became *more* costly, while Mexican cattle exports to the U.S. market became *less* costly.

The effect of the peso devaluation was felt most in the first half of 1995, for by the last quarter of the year, cattle imports were at about the same level as a year earlier.² Adjustment as seen in the current account balance may be largely behind for Mexico; however, Mexico is still recovering.

Economic Contraction in Mexico. Historically, Mexico's economy and U.S. total exports to Mexico have moved in the same direction.³ When Mexico's economy has grown, U.S. exports to Mexico also have grown, and when Mexico's economy contracted, U.S. exports to Mexico contracted. The reason these two measures move together is that as Mexico's economy grows (or contracts), Mexican consumers have more (or less) income to spend on all products and services, including imports.

The link between the two measures has not changed with NAFTA. In 1993, the year before NAFTA, the Mexican economy grew at an almost flat 0.4%, and total U.S. exports to Mexico grew at 2.4%. In 1994, the first year of NAFTA, Mexico's economy grew at a strong 3.5%, and total U.S. exports grew by 22.3%. In 1995, however, Mexico's economy contracted by 6.9%—the largest one-year decline since the Depression—and total U.S. exports fell by 10.7%. Looking only at U.S. agricultural exports, the same relationship was seen, except that the rates of growth and contraction were even greater.

If Mexico's economy turns around in 1996, then U.S. exports to Mexico could increase. The U.S. Department of the Treasury reports that Mexico's recession probably

¹ For more information on the peso devaluation, see U.S. Library of Congress. Congressional Research Service. *Mexico's Financial Crisis and U.S. Support Efforts*, by (name redacted). CRS Report No. 95-211 F. Updated February 3, 1995. 6 p., and *Mexico's Recent Economic Performance: A "Snapshot,"* by (name redacted). CRS Report No. 95-1033 E. October 11, 1995. 6 p.

² U.S. Department of Agriculture. Foreign Agricultural Service. *Livestock and Poultry: World Markets and Trade*. March 1996. p. 47.

³ See U.S. Library of Congress. Congressional Research Service. *NAFTA, Mexican Trade Policy, and U.S.-Mexico Trade: A Longer-Term Perspective*, by (name redacted). CRS Report No. 96-225 E. March 11, 1996. 17 p.

reached its lowest point in the middle of 1995.⁴ The Treasury report states that Mexico's economy grew by 2.8% and 2.3% during the third and fourth quarters of 1995, respectively, and it cites a forecast of 2.2% in real economic growth in 1996.

Drought and Other Problems. The northern states of Mexico experienced severe drought in 1994 and 1995, which caused an immediate increase in cattle shipped to the United States, as Mexican ranchers quickly sold their cattle for export. Nevertheless, about 300,000 cattle in Mexico perished because of the drought, according to Mexico's National Livestock Confederation.⁵ Higher exports and deaths cut Mexico's herd by 8% during 1995, according to one estimate.⁶ The higher exports that were caused by drought are not expected to continue into 1996. The herd size is smaller, fertility rates have fallen, and the drought has not ended.

Other problems have hurt the Mexican cattle industry as well. The peso devaluation pushed up prices for inputs (drugs for the animals, feedstuffs, and machinery).⁷ Credit problems discourage capitalization. As long as the drought and other problems continue, Mexico's herd is unlikely to grow much, and analysts do not expect exports to the United States to reach the levels seen in late 1994 and 1995.⁸

NAFTA and Cattle Trade

The three developments discussed above were important reasons for higher U.S. imports and lower U.S. exports of cattle, but was NAFTA also an important reason? Looking at NAFTA's provisions relating to cattle trade, the trade agreement most likely was not a notable cause of worsened cattle trade with Mexico.

Absent the other, unexpected developments, if anything the tariff provisions of the trade agreement should have increased U.S. exports more than imports. Mexico had a 15% tariff on cattle before NAFTA and immediately eliminated the tariff under the trade agreement. Under normal circumstances, this would have been expected to increase U.S. exports to Mexico. Moreover, before NAFTA, U.S. imports of purebred breeding and dairy cattle entered tariff-free, so there was no change under NAFTA, and U.S. imports of other cattle had a tariff of about 1 cent per pound, which was eliminated immediately under NAFTA.

Less direct changes were made under other NAFTA provisions. Sections on animal health, import licensing, and border inspections were expected to facilitate trade in both

⁴ U.S. Department of the Treasury. *Treasury Secretary's Report to Congress on Mexico*. Updated April 4, 1996. On Internet at, <http://www.ustreas.gov/treasury/mexico/top.html>.

⁵ Aspin, Chris. Mexican Drought Hits Northern Cattle Farms. *Reuters*, March 21, 1996.

⁶ U.S. Department of Agriculture. Economic Research Service. *Cattle and Sheep Outlook*. November 13, 1995.

⁷ American Embassy in Mexico City. *Livestock*. Post Report to USDA/FAS. August 1, 1995.

⁸ Data for the first three months of 1996 suggest that Mexico's exports of cattle to the United States may be down over 60%, according to U.S. Department of Agriculture. Economic Research Service. *Livestock, Dairy, and Poultry Monthly*. March 25, 1996.

directions by clarifying rules and simplifying paperwork. Sections on safeguards (temporary imposition of trade barriers to protect a threatened domestic industry) and dispute settlement were intended to address disruption and conflict that might arise. The provisions were intended to increase trade by providing a more predictable and stable trading system and were not expected to change the immediate level of trade unless they were invoked.

NAFTA and Cattle Prices

Some in the cattle industry have blamed NAFTA for the drop in cattle prices that has taken place since 1993. This position was well-known in Mexico: Mexican cattlemen were "...concerned about the U.S. industry perception that record Mexican live cattle exports have contributed to reduce U.S. southern cattle prices."⁹ As at least one U.S. farming source reported, however, "There was definitely a regional price effect. But NAFTA didn't cause it."¹⁰

The drop in cattle prices was due to causes other than NAFTA. Chief among them were high grain prices and large cattle supplies.¹¹ When grain prices are high, feedlots, which fatten cows on grain before slaughter, must pay more for feed and pay less for cattle. Corn prices are at record levels and have pushed down cattle prices.

The supply of cattle is at a high point in the multiyear supply cycle. More calves are still being born even though prices are falling, so the supply of cattle may not fall for another year or two. Cattle supplies include imports from Mexico, but imports are only a small share of total supplies. Imports from Mexico during 1995 were at most only about 1% of the total U.S. cattle herd, and even feeder imports (cattle that are at the grain-feeding stage before slaughter), which were the major share of imports, represented only 4-5% of all U.S. feeder cattle. Thus, imports from Mexico were not the major determinant in the drop in cattle prices.

⁹ American Embassy in Mexico City. *Livestock*.

¹⁰ Mexican Feeder Cattle Flood Eases. *Progressive Farmer*. April 1996. p. 60

¹¹ U.S. Library of Congress. Congressional Research Service. *Cattle Prices: Questions and Answers*, by (name redacted). CRS Report No. 96-115 ENR.

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