

International Agri Insights

with Professor Bill Bailey

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NAFTA: Every which way but loose

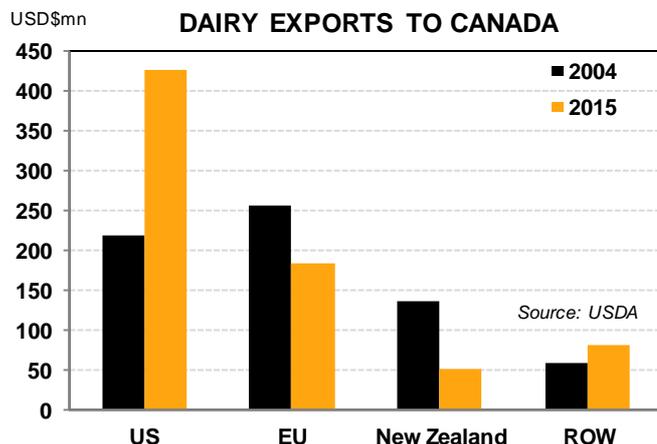
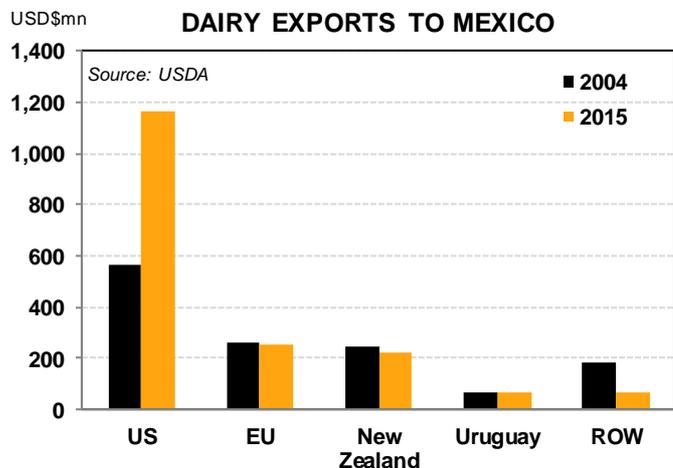
- NAFTA negotiations are underway, and anything is possible at this juncture.
- Regardless of the outcome, NZ dairy is an interested party and potentially could stand to gain.
- However, failed NAFTA negotiations could lead to a broader slowdown in global trade liberalisation.

NAFTA negotiations are up in the air

The North American Free Trade Agreement (NAFTA), between the United States, Mexico and Canada, has been part of the trade environment since 1994. Under the agreement, tariffs between the three countries were progressively eliminated and, by 2008, all duties and quantitative restrictions were eliminated.

One exception in the treaty was in the agricultural area where, for a limited number of agricultural products traded between the US and Canada, trade restrictions were kept in place and remain so today. Since the agricultural portions of the treaty were based on bilateral negotiations, the US treats trade with Mexico under different rules than trade with Canada.

While there have been a number of studies that indicate the positive aspects of NAFTA on the three countries, NAFTA remains somewhat contentious. When the status of NAFTA was last discussed in the [June 2017 edition](#) of this column, its future was uncertain. That future was further clouded when Canada closed its border, this spring, to certain US dairy exports to which the US responded with a tariff on Canadian lumber imports.



Trump looms large over negotiations

US President Trump initially assessed NAFTA as “the worst trade deal maybe ever signed anywhere, but certainly ever signed in this country.” Possibly in response to intense lobbying, mostly from agricultural interests, he subsequently modified that stance to indicate a willingness to enter into negotiations. Those negotiations began on August 16 of this year as representatives of the US, Mexico and Canada sat down together in Washington, DC.

It was against this background of ongoing NFATA negotiations that President Trump, at a campaign rally in late August, hedged his support of the negotiations when he suggested the US would “end up probably terminating NAFTA, at some point”, although he said had not yet made his final decision. President Trump’s statement that the US would probably terminate NAFTA is not new and is consistent with his statement, made earlier this year, that he would not terminate NAFTA “at this time.”

A prolonged NAFTA negotiation is likely to hurt North American trade

The trading environment will become increasingly difficult the longer the uncertainty created by renegotiating NAFTA continues. The uncertainty is based on how import and export market opportunities might change, as the positives and negatives of the negotiations are evaluated. As with any negotiations, there will be both winners and losers, but the potential exists for NAFTA to be either fundamentally renegotiated or terminated. Either outcome will have a broad market impact affecting the world’s trading environment.

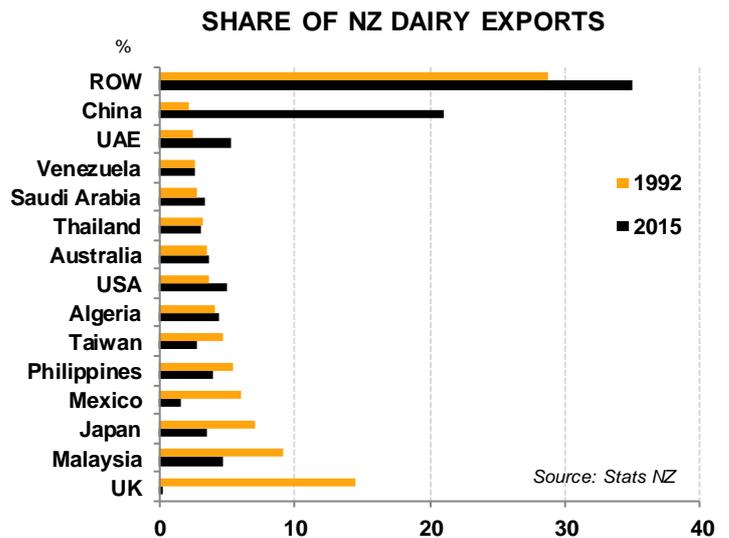
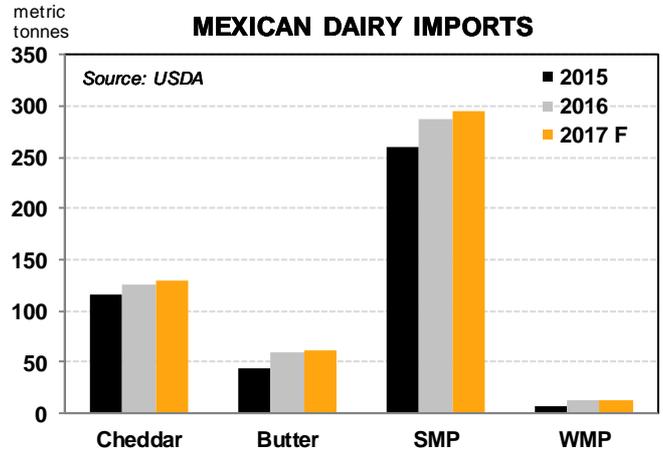
This column evaluates the potential consequences of both outcomes on the export market for New Zealand dairy. A later column will do the same for New Zealand beef.

Mexico is the US dairy industry’s largest customer. Between 2004 and 2015, the US increased its market share for dairy exports to both Mexico and Canada. New Zealand, however, lost market share in those markets.

The US relationship to Mexico should remain positive, even with a less-than-fully satisfactory NAFTA Agreement. This conclusion is based on an announcement made following the recent August meetings. The US and Mexican dairy industries issued a joint statement that listed 9 priorities for the negotiations. The priorities included support of efforts to modernize the agreement, an improvement in commercial trade by ensuring the free flow of dairy products, the elimination of trade barriers and requesting the full inclusion of Canada in dairy trade negotiations. This last request could set the stage for dairy negotiations between all parties rather than the bilateral approach previously used.

Mexico is a significant importer of dairy products, particularly skim milk powder and cheese, so it will be affected, either for better or for worse, by the outcome of a final NAFTA agreement.

New Zealand is an important dairy import source and provides 90% of Mexico’s butter imports and 61% of the country’s whole milk powder imports. In what is seen as an indication of the Mexican dairy industry taking measures



to avoid product shortfall in case of failed negotiations, the industry recently signed a trade agreement with Argentina and is sourcing 20% of its WMP needs from that country.

If NAFTA negotiations fail, NZ dairy could pick up the slack in Mexico...

Based on the above data, a negative outcome of the negotiations could strain the US-Mexico dairy partnership, particularly in view of those countries wishing to change NAFTA to open up the protected Canadian dairy industry.

However, with Mexico reliant on imported dairy products, a negative outcome could be beneficial for New Zealand dairy exports. That is, NZ could potentially fill the gap left by a fall in US dairy exports to Mexico. Although New Zealand's volume of butter and SMP exports to Mexico are very important to that country, Mexico's importance to the New Zealand export market is not similar. Mexico, as an export market destination, ranks only slightly above the United Kingdom as a final product destination. While China clearly remains the key New Zealand export market, a negative NAFTA outcome could provide an opportunity for additional diversification of New Zealand dairy export markets.

A negative outcome could have a direct impact on Canadian-Mexico dairy trade since Mexico looks to Canada for 20% of its SMP imports and 5% of its WMP needs. Canada is not a destination for any Mexican dairy exports. A negative NAFTA outcome would have limited direct impact on Mexico-Canadian dairy trade because of the limited dairy trade between the two countries. Canada is the source for about 20% of Mexican imports of SMP, 5% of WMP and very minimal quantities of other dairy products.

...and in Canada

A negative or no NAFTA would affect New Zealand trade with Canada, although it is not clear if the impact could be positive or negative. A negative agreement would send Canadian butter buyers looking for additional sources because until 2016 the US has been the source of nearly 40% of Canadian butter imports. New Zealand has come a close second. The question is whether Canada would look to New Zealand for butter to replace US exports.

US-Canadian dairy trade would clearly be significantly affected, as the US is a major source of Canadian dairy imports, particularly for cheddar cheese and SMP. And the US, in turn, is a major Canadian trading partner for a lot of dairy products.

A central issue to watch, during the negotiations, is how successful Mexico and the US are in their efforts to bring Canadian dairy policy into the negotiations. In view of the importance of US dairy exports to Mexico, and Mexico's need for those exports (when contrasted with the longstanding domestic dairy industry protection efforts of Canada), three-way negotiations could be very difficult. Such efforts might lay the groundwork for a failed NAFTA, even without President Trump's intervention. Alternatively, other sectors of US agriculture, such as the feed grain sector, may prefer to continue traditional bilateral discussions in order to protect the significant role Mexico has as a feed grain buyer.

A key point to remember is New Zealand dairy will be affected by the outcome of distant trade discussions in which it is not directly involved. While New Zealand could gain if its current trading partners – the US, Canada and Mexico – are happy with a new NAFTA, it also could gain if those countries, particularly Canada, walk away from the talks.

Lastly, failed NAFTA negotiations could signal wider moves to trade protectionism

Of the possible outcomes from the negotiations, the one of most concern to New Zealand is that a failure of the talks could lead to increased trade protectionism on a broad international scale. Alternatively, successful negotiations could provide a very positive counterpoint to current protectionist positions taken by some politicians in all three countries.

About the author

William C Bailey was Chair of Agribusiness at Massey University for 13 years. He has written weekly world dairy market columns for ASB Bank for almost 15 years. He currently is President of Topker Consulting, specializing in agricultural market research and supply chain issues relevant to agriculture. He retired as Dean, College of Business and Technology, at Western Illinois University, in Macomb, Illinois, in July, 2017. Bill spent 5 years in the US Marine Corps and received his PhD in Agricultural Economics from the University of Missouri. Before shifting to New Zealand, Bill was Chief Economist for the US Senate Committee on Agriculture, Nutrition and Forestry, served as Deputy Undersecretary of Agriculture and was Vice President and Director of Research for World Perspectives in Washington, DC. His beer of choice is Tui.



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