The Peru-US Trade Promotion Agreement (TPA): Possible impact on Peruvian agriculture

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Summary

Trade negotiations between Peru and the United States started on May 18, 2004 and concluded on December 7, 2005 with the signing of a Trade Promotion Agreement (TPA). This article summarizes the most important aspects of the reciprocal opening of agricultural markets between both countries and examines the possible economic impact of the TPA from the global and sectoral perspectives, as well as from the point of view of products or agro-production chains.

The conclusion is that the elimination of tariffs on imports from the United States would have a limited impact on the competitive position of most agricultural products on the domestic market, basically due to the fact that most of the opening of trade in many agricultural subsectors involves relatively low tariffs, and high protection is circumscribed, involving three lines of products (rice, sugar and dairy products). This study describes the differences in the impact of the TPA in terms of sensitive products, native products or tropical products destined for the domestic market, or export products.

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Background

Since the early nineties, Peru has been the most persistent of all the Andean countries in pursuing a policy to open up foreign trade. The importance of Peru's foreign trade in relation to its Gross Domestic Product can be seen in the 64% growth rate over the last 15 years. Total exports, on the other hand, grew at an annual average rate of 9%. This dynamic has largely been the result of the Andean Trade Promotion and Drug Eradication Act (ATPDEA) which afforded the Andean countries special access for their products on the United States market. In 2004, more than 12% of Peruvian exports reached the US market under this preferential system. If we exclude the petroleum and petroleum byproducts trade, Peru is the Andean country that most profited from the ATPDEA.

In this context, the negotiation of a trade agreement with the US was intended primarily to consolidate and expand the tariff preferences granted under the ATPDEA and to promote greater stability and security for investment, exports and jobs generated in the domestic economy. That negotiation started on May 18, 2004 and concluded on December 7, 2005 with the signing of a Trade Promotion Agreement.

Reciprocal opening of agricultural markets

The TPA consolidates tariff-free access to the US market for 90% of tariff items from the agricultural sector, including all products currently benefiting from the ATPDEA. This means that commodities that are important for Peru, such as artichokes, onions, asparagus, mango, dried vegetables, paprika, plantain, grapes, and other fruits and vegetables, as well as ethanol, will continue to enjoy uninterrupted preferential access to the United States at zero duty, on the entry into effect of the agreement. In addition, with the TPA, this preferential access will be extended to other products such as olives, cotton fiber, other vegetable and fruit preserves where Peru is a highly competitive producer on the world market.

Other agricultural items that are not marketed on a large scale will be subject to tariff elimination over a five- to 17-year period, depending on the sensitivity of the products involved. This reduces the medium- and long-term uncertainty about access to the United States market and the expectation is that an increase in, as well as a diversification of, exports as well as investments in agriculture will be facilitated.

For its part, Peru agreed to eliminate immediately tariffs on 56% of imports originating in the United States, i.e., 89% of the total value imported from that country. For 125 tariff items in the sensitive products category, such as refined oils, rice, beef, chicken leg quarters, dairy products, hard yellow corn, the elimination of tariffs will have a ten- to 17-year phase-out period. For these products, however, Peru will partially open its market on the entry into force of the agreement by means of 0 duty tariff rate quotas, which will increase annually and which will be subject to the application of safeguard measures.

Estimated impact of the TPA

Throughout the negotiation process, a number of government agencies, trade union associations and academic and research institutions have endeavored to assess the likely impact of the TPA on the Peruvian economy through studies that have varied in depth of scale and that have been based on different methodologies, statistical information and hypotheses. In general, these studies may be differentiated according to their overall or sectoral coverage or coverage by product. They may also be differentiated according to their method of analysis, since many of them are based on a qualitative analysis using selected statistical series from which logical conclusions may be drawn. Others are more quantitative in character and are based on the use of econometric or accounting models. This article reviews the leading studies on the effects of trade liberalization with the United States, especially in the agricultural area and includes the results of the model for assessing the impact on the agricultural sector used by IICA.

Overall impact assessment

Noteworthy among the overall studies are those conducted by Pizarro (2004), at the Ministry of Foreign Trade and Tourism (Ministerio de Comercio Exterior y Turismo -MINCETUR) and by the Inter.-American Development Bank (IDB); by Morón (2005) at the Research Center of the University of the Pacific; and by Escobal and Ponce (2006) from the Group for the Analysis of Development (GRADE).

The first two studies sought to estimate the economic impact of tariff concessions granted mutually by Peru and the United States and trade earnings arising from a more efficient allocation of resources and from increased prospects for consumption with the signing of the TPA. All of the studies agree that the Peruvian economy would stand to benefit from the signing of the TPA and estimate that Peruvian exports will be consolidated on the North American market. Employment would also be promoted in the production sectors, which would make the economy as a whole more dynamic and generate wellbeing in the entire population.

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The study by MINCETUR estimated that, as a result of the entry into force of the TPA, Peruvian GDP would grow by 2,3%. This growth is explained by the 0 duty access to the North American market and the reduced prices for importing final and intermediate goods, which would benefit national producers and consumers. What is more, production would go up as a result of increases in certain manufactures and agricultural export products, such as vegetables, fruits and other crops.

One finding of the MINCETUR study that might come as a surprise to some is the relative increase in imports from the United States (44%), as compared with a 31% increase in Peruvian exports to that market, using 2002 figures as a baseline. This situation could be explained by the fact that Peru already enjoys most of the tariff benefits under the ATPDEA, whereas the United States would gain new advantages it did not enjoy prior to the TPA.

This finding is similar to that described in the report of the United States International Trade Commission, which estimates a 25 per cent increase in US exports to the Peruvian market, whereas Peruvian imports to the US market would increase by 8% over recorded levels in 2005. One possible explanation for the difference between the two findings is the base year used for the projections.

The model of the University of the Pacific estimates the expected effects 20 years after the entry into force of the TPA, using 2002 as a base year. This study suggests that the positive effects expected from the signing of the TPA would depend on the possibility of expanding the productivity of all inputs which, in recent years, have not experienced growth. This study calculates an increase of 3,3% to 4,9% in GDP, depending on the scenario and premises used.

The third overall study presented by Escobal and Ponce (2006) uses a general equilibrium model and seeks to establish ranges with regard to the impact that the TPA tariff elimination would have on rural households in the three Peruvian regions (coastal, mountain and forest regions). In this study, the results of trade liberalization are positive, since they translate into increased wellbeing, in the amount of 215 to 417 million dollars (0,32% to 0,61% of GDP). However, the rural sector could be affected by the tariff reduction which would apply to maize and rice produced in the forest region, and dairy products and meats from the mountain region.

Sectoral impact assessment

The main concern of agricultural unions in Peru has been the possible effect that duty- free imports from the United States could have on “sensitive” products. Several criteria have, however, been used to determine the degree of “sensitivity” of the various products facing US competition. An initial set of criteria takes into account the importance of the headings in production, employment and income in the agrifood sector.

In this sense, the potentially sensitive products, such as grains (wheat, yellow corn, barley), cotton and rice accounted for approximately 41 % of the harvested area, equivalent to 35% of the gross value of agricultural output from 2004-2005. Products that are not “sensitive” and that are capable of competing advantageously with imports from the US, as well as native or tropical products destined for domestic consumption, and export crops, account for the rest of the harvested area.

No direct negative impact can be expected for products such as amylaceus maize, quinoa, Ullucus tuberosus, broad bean, coffee, cacao, plantain and other tropical fruits on the domestic market since the United States does not produce these crops.

For some other products, the displacement of national production is highly unlikely, given the consumption patterns of Peruvians which relate to the flavor and freshness of the product, and eating habits (whole fresh potato vs. frozen sliced potato). In other cases, the reasons have to do with economics, and relate to the price differential and/or the heavy impact of transport costs on the price of the imported product (beef, fructose syrup).

In accordance with the sectoral studies conducted by IICA, in conjunction with MINAG and MINCETUR, the possible negative effect on output would be limited to four products: wheat, cotton, corn and rice. This would be in response to the net increase in imports with regard to these specific products. It bears noting that in many instances, trade liberalization would divert trade from other competitive countries to the United States. (Table 1).

	MINCETUR			IICA	
	Prod.	Export.	Import.	Prod.	Import.
Unhusked rice	0.6	0.0	11.0	0.4	13.4
Processed rice	-0,2	-0.1	2.4	0.4	1.1
Hard yellow corn	n.d.	n.d.	n.d.	-0.4	1.9
Wheat	-4.7	-0.1	8.0	-4.6	2.0
Other cereals	0.4	-2.8	4.1	n.d.	n.d.
Vegetables, fruits and nuts	2.8	8.7	6.2	n.d.	n.d.
Sugarcane and beets	1.7	0.0	6.7	0.5	n.d.
Sugar	1.6	0.6	6.9	0.5	-0.6
Cotton	-2.4	-3.9	8.6	0.6	n.d.
Other crops	2.9	9.8	11.4	n.d.	n.d.
Cattle	1.7	-3.9	6.9	n.d.	n.d.
Chicken meat	n.d.	n.d.	n.d	0.2	4.9
Beef meat	n.d.	n.d.	n.d	0.3	1.2
Pork meat	n.d.	n.d.	n.d	0.2	0.6
Dairy products	1.7	7.7	6.3	n.d.	n.d.
Whole milk	1.7	-11.8	8.3	0.5	n.d.
Other products of animal origin	1.4	-1.9	8.7	n.d.	n.d.
Meat products	0.7	-4.2	27.1	n.d.	n.d.
Other meat products	1.1	-5.3	43.1	n.d.	n.d.
Other food products	0.8	-0.4	5.6	n.d.	n.d.

Table 1. Impact of the TPA on sensitive agricultural products (% variation)

Source: Prepared on the basis of the findings included in the studies by Moron (2005) and MINAG (2006)

These studies conclude that Peruvian imports from the United States would increase in relation to levels recorded in 2002. This is a logical outcome, given the preferential opening under the TPA and the resulting estimations for this heading are quite moderate, all the more so if we consider the low figures for imports from the United States recorded in the base year, 2002.

Impact assessments according to product

Several studies conducted by the Ministry of Agriculture are aimed at assessing the degree of competitiveness of products considered sensitive that are intended for the Peruvian domestic market, in the face of potential imports from the United States (MINAG 2006). Here, the CIF prices for importing US products in the period 2000-2005 were taken into account (cost of insurance and freight) and were compared with the prices of locally produced similar products at the same sales point.[3]

Cereals

The hard yellow corn-poultry-pork chain would maintain their competitive position on the domestic market vis-à-vis potential imports from the United States. During the period 2004-2005, Peruvian yellow corn competed with imported corn originating in Argentina, the delivery price of which was estimated to be 10% lower than the delivery price of US corn. The elimination of tariffs in favor of the United States might not make up for that differential given the current trend towards an increase in the price of yellow corn on that market.

Moreover, compensation in favor of corn producers, to which the Peruvian government has committed itself during the negotiation of the TPA, should contribute towards an increase in production levels, inter alia, from the increased use of certified seed.

No significant impact is expected for the national production of wheat either. On the one hand, notwithstanding the reduced national output of wheat, there will be no competition with wheat imported from the United States which is of a different quality and has different uses and destination markets. On the other hand, those producers who sell their product to industrial mills will benefit from a compensation program to which the government committed itself during the negotiation.

With regard to wheat-based final products, it has been estimated that without the tariff, in the best case scenario, the nationalized price of wheat would drive down the price of wheat flour by approximately 4%. Three per cent of that reduction would be passed on to the price of noodles and two per cent

[3] For most of the products considered sensitive for Peru, US prices continued to increase in 2006 and show an upward trend for the next ten years (this is the case with rice, corn, wheat, cotton, sugar, pork, milk and sugar) See projections through 2016 from the Food and Agricultural Policy Research (FAPRI) and the ERS.

would be passed on to the price of bread. For this reason, the hope is that the effects of the substitution in consumption, in favor of wheat derivatives and to the detriment of local products like potato, will be limited.

With respect to rice, two scenarios with different relative prices for US imports and locally-produced rice have been estimated (average prices for the last year and average prices for the last five years). In both cases, the reduction in tariffs for North American rice could generate an increase in those imports, which would, in principle, displace Uruguayan rice imports (trade diversion) in the high-quality rice market segment. National output could also be displaced and assistance would therefore be required for adjustment purposes.

This crop is not considered among the direct compensation measures, but rather in investment programs for land drainage and reclamation programs. This is because rice cultivation contributes to the problem of soil salination, especially on the coast, because of high water consumption. It is estimated that an area covering 146,000 hectares is severely affected by this problem. In this regard, support measures anticipated by the government during the negotiation are established in the following programs:

- **a.** Investment for drainage and reclamation of salinized lands;
- **b.** Redirection towards other crops;
- **c.** Reduction in the transaction costs related to rice from the forest regions to improve competitiveness.

Meats

Trade in chicken meat. Comparative price studies allay fears about a possible massive increase in imports. It is estimated that these imports would be moderate due to the following:

- **a.** Consumption patterns in Peru show a preference for fresh meat.
- **b.** Insufficient refrigeration infrastructure for the commercial management of frozen poultry.
- **c.** The limited price differential that could result from the total elimination of tariffs and duties.
- **d.** The relative downturn in the price of hard yellow corn and other inputs for production vis-à-vis competitors in the United States.

The competitiveness of the poultry sector is expected to improve as a result of support for the corn-poultry chain producers to which the government has committed itself.

Beef. Standard beef, such as prime and choice grades from North America that

would enter the domestic market through the quota and therefore, without the payment of tariffs would be twice the price of similar meats produced locally. However, the quota-based entry of edible leftovers (entrails) from the United States could bring down the consumer prices of these byproducts as well as the income of stock farmers in this heading, which currently accounts for 6% of income per head of cattle.

The results of the simulation of the nationalized prices of reconstituted milk prepared with skimmed milk powder (SMP) and anhydrous milk fat (AMF) imported from the United States show that despite the elimination of taxes, they are still higher than national price levels. In the case of whole milk powder (WMP), price levels after the elimination of taxes are ten per cent higher than national prices.

Pork. There should be no significant increase in imports, due to the limited difference in prices. However, a displacement in imports from Chile, which enjoys free entry to the Peruvian market, is to be expected. It is important to emphasize, however, that these effects are subject to any support programs established for this sector.

Dairy products

In the case of dairy products, bilateral trade will be regulated by tariff rate quotas and the long-term phasing out of taxes and customs duties. The results of the simulation of the nationalized prices of reconstituted milk prepared with skimmed milk powder (SMP) and anhydrous milk fat (AMF) imported from the United States show that despite the elimination of taxes, they are still higher than national price levels. In the case of whole milk powder (WMP), price levels after the elimination of taxes are ten per cent higher than national prices.

USDA projections show a 12% rise in the prices of dairy products over the next ten years, due primarily to the increased cost of cattle feed. However, by the first half of 2007, the international prices of whole milk powder were 64% higher than the average in 2004-2005. National milk is therefore more competitive than imported milk from the United States, all the more so when the price trend over the past two years is taken into account. Another positive factor in terms of the competitiveness of the sector has been the improvement in domestic cattle farming for milk production.

Cotton

With regard to cotton, the tariff reduction (12%) would bring about a 10% drop in the nationalized price. This would apparently lead to an increase in imports. However, one factor to be taken into account is the fact that the national textile industry depends more on the domestic supply of tanguis cotton which has better properties than imported cotton.[4]

Despite the fact that the prices of American cotton (upland variety) are higher than those from the other suppliers, the lower cost of imports could also result in a displacement in imports from Brazil, Bolivia and Argentina. This crop is included in the tariff reduction compensatory program proposed by the Peruvian government during negotiation of the TPA, which would make it possible to maintain a competitive position vis-à-vis the United States.

Sugar

The TPA poses a challenge for the Peruvian sugar industry because of the possible entry of tariff-free high-fructose corn syrup. On the other hand, that agreement ensures for Peru access for the future Peruvian production of ethanol to the North American energy market. The balance is clearly positive for the sugar sector as regards costs and benefits in the medium and long term, especially following the clear-cut decision by the US to increase the use of ethanol as an oil substitute.

The likely increase in Peruvian imports of US fructose will depend on trends in the domestic and international prices of sugar as compared with fructose, which will ultimately be affected by high oil prices. In this regard, the tariff reduction for fructose imports under the TPA is hardly significant when compared with the momentous changes that have taken place in the international sugar sector over the last two years.

Good times are therefore ahead for the Peruvian sugar industry as a result of continuing high international prices, even if fructose imports increase as a result

[4] Tanguis cotton offers better conditions than American imported cotton for the process of opening, carding, combing and spinning. Losses in Tanguis cotton are 14% versus 21% in the upland cotton. American cotton also has more neps (knots that form in the fibers), which must be eliminated with the combing. What is more, the process of dying tanguis cotton makes it possible to save on chemical products and dyes in the dying process (approximately 30%) because it has less dye affinity and less impurities.

of relatively lower prices in relation to the price of sugar on the world market.

Conclusions

The favorable prospects that might be expected for Peruvian agriculture under the TPA are clearly related to the initial economic situation with regard to the opening up of trade in that country. Many agricultural subsectors enjoyed fairly low tariffs and high protection was concentrated in three lines of products (rice, sugar and dairy products). This is why the elimination of tariffs on imports from the United States would generally have a limited impact on the competitive position of most agricultural products on the domestic market.

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The foregoing was borne out by the findings of the impact studies conducted at the overall, sectoral and by product levels, especially when price comparisons are taken into account. This conclusion would seem to be reinforced by projections of international price increases over the next ten years by various international research institutes.

Despite the overall positive effect of the TPA on the agricultural sector, according to studies conducted, adjustments would need to be facilitated in certain subsectors and regions that could be affected by competition from imports. Accordingly, during the negotiations, consideration was given to applying a compensation system for a limited group of sensitive products and instituting a series of agricultural policy measures to reinforce the competitiveness and modernization of the agricultural sector so as to inject vitality into the sector and ensure increased income growth and employment in the rural milieu.

In other words, measures would have to be adopted to develop agricultural exports and facilitate adjustments in production intended for the domestic market, given the new conditions for competition.

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Résumé / Resumo / Resumen

L'accord de promotion du commerce entre le Pérou et les États-Unis. Ses répercussions éventuelles sur l'agriculture péruvienne

Les négociations commerciales entre le Pérou et les États-Unis ont commencé le 18 mai 2004 et se sont terminées le 7 décembre 2005, par la signature d'un Accord de promotion du commerce (APC). Cet article résume les aspects les plus importants de l'ouverture réciproque des marchés agricoles entre les deux pays et analyse l'éventuel impact économique de l'APC dans une perspective globale, sectorielle et par produits ou filières agroproductives.

Il conclut que l'élimination des droits de douane sur les importations en provenance des États-Unis n'aurait, que peu d'impact sur la position concurrentielle sur le marché national de la plupart des produits agricoles, essentiellement parce que la plus grande ouverture commerciale de bon nombre de sous-secteurs agricoles s'effectue sur la base de tarifs douaniers relativement faibles et que la forte protection se concentre sur trois lignes de produits (le riz, le sucre et les produits lactés). Cette étude montre les différences d'impact de l'ACP selon qu'il s'agit de produits sensibles, de produits natifs ou de produits tropicaux destinés au marché national ou de produits d'exportation.

O acordo de promoção comercial Peru-Estados Unidos: possíveis impactos na agricultura peruana

As negociações comerciais entre o Peru e os Estados Unidos iniciaram-se em 18 de maio de 2004 e concluíram em 7 de dezembro de 2005 com a assinatura do Acordo de Promoção Comercial (APC). Este artigo resume os aspectos mais importantes da abertura recíproca dos mercados agrícolas entre esses dois países e analisa o possível impacto econômico do APC sob a perspectiva global, setorial e por produtos ou cadeias agroprodutivas.

A conclusão é que a eliminação de tarifas nas importações dos Estados Unidos teria um impacto reduzido na posição competitiva da maioria dos produtos agrícolas no mercado interno. Isso se deve, basicamente, a que a maior abertura comercial de muitos subsetores da agricultura se dá a partir de tarifas relativamente baixas e ao fato de a alta proteção concentrar-se em três linhas de produtos (arroz, açúcar e derivados do leite). Este estudo mostra as diferenças no impacto do APC quando se trata de produtos sensíveis, nativos ou tropicas destinados ao mercado interno ou de produtos para exportação.

El acuerdo de promoción comercial Perú-EE.UU. Posibles impactos en la agricultura peruana

Las negociaciones comerciales entre Perú y EE.UU. iniciaron el 18 de mayo de 2004 y concluyeron el 7 de diciembre de 2005, con la firma de un Acuerdo de Promoción Comercial (APC). En este artículo se resumen los aspectos más importantes de la apertura recíproca de los mercados agrícolas entre ambos países y se analiza el posible impacto económico del APC desde una perspectiva global, sectorial y por productos o cadenas agroproductivas.

Se concluye que la eliminación de aranceles para las importaciones desde los EE.UU. tendrían un impacto reducido en la posición competitiva de la mayoría de productos agrícolas en el mercado interno, debido fundamentalmente a que la mayor apertura comercial de muchos subsectores de la agricultura se da a partir de aranceles relativamente bajos y la alta protección se concentra en tres líneas de productos (arroz, azúcar y lácteos). Este estudio da cuenta de las diferencias en el impacto del APC cuando se trata de productos sensibles, productos nativos o productos tropicales destinados al mercado interno o productos de exportación.