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**FACTORS AFFECTING TRADE IN MEXICAN IMPORTS OF  
POULTRY MEAT FROM THE UNITED STATES**

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# FACTORS AFFECTING TRADE IN MEXICAN IMPORTS OF POULTRY MEAT FROM THE UNITED STATES

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**ABSTRACT:** U.S. exports of poultry to Mexico have increased steadily since NAFTA came into force in January 1994. The Mexican poultry industry has become increasingly concerned about these exports, arguing that it cannot compete with U.S. products. The Mexicans argue that U.S. poultry exports to Mexico are duty free under NAFTA (as of January 1, 2003). The Mexican industry also argues that U.S. poultry benefits from low-priced feed resulting from U.S. Government farm programs. We analyzed the impact of tariffs and U.S. feed grain programs on U.S. exports of poultry, and find that other factors appear to be more important in explaining trade. Specifically, Mexican preferences for dark meat provide large price incentives for U.S. exporters, while Mexican Government policies in support of its grain sector penalize poultry producers in Mexico.

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<sup>1</sup> The views expressed in this article are those of the authors. They are not the views of the International Trade Commission or any of the Commissioners.

Since NAFTA came into force in January 1994, Mexican agricultural exports to the United States (accounting for 80 percent of all Mexican agricultural exports) have more than doubled, reaching in excess of \$7 billion last year.<sup>2</sup> U.S. foreign investment in Mexico has also grown to record levels in recent years under NAFTA. Mexican agricultural production of all major crops and livestock has expanded over the past 10 years in spite of increased competition from U.S. imports.<sup>3</sup> Although overall Mexican production and exports have expanded, there is concern that gains of increased trade and investment have not been shared equally within Mexico's agricultural sector, and the vast majority of Mexico's small farmers, or "campesinos," remains poor.<sup>4</sup>

Faced with declining rural incomes and increasing poverty, farm worker groups, such as "The Farmland Can't Stand Anymore," El Barzon, and the National Farm Workers' Confederation (CNC), claim increased agricultural imports under NAFTA are to blame for declining incomes.<sup>5</sup> In January, 2003 the PRD party joined these groups in submitting a position paper before the Mexican Congress calling for the renegotiation of NAFTA's chapter on agriculture. So far the call to reopen NAFTA has been resisted by President Fox, despite considerable political pressure on him to do so and mid-term elections in early July 2003.<sup>6</sup> The United States has expressed no interest in NAFTA renegotiation.

Under NAFTA, Mexican tariffs on all but a few imported agricultural products from the United States were eliminated as of January 1, 2003, with the exception of corn, beans, milk powder, and sugar. According to the opponents of NAFTA, Mexico's small- and medium-sized farmers cannot survive the competition from U.S. exports, given the efficiency and low-cost structure of U.S. agriculture.<sup>7</sup> In addition to objecting to tariffs, Mexicans on all sides of the NAFTA debate complain bitterly that U.S. farm programs have tilted the playing field sharply in favor of the United States.<sup>8</sup> In particular, the 2002 Farm Act<sup>9</sup> will provide farm payments of about \$107 billion over the next 10 years to farmers (excluding unanticipated emergency payments), which, in the view of many Mexicans, will encourage U.S. production and depress prices to the detriment of Mexican farmers.<sup>10</sup> U.S. officials counter by claiming that farm support remains within limits established under the WTO Agriculture Agreement and that spending on farm programs under the new legislation is not significantly different from the previous several years.<sup>11</sup> Such arguments have done little to change Mexican sentiment. Most Mexicans view U.S. farm programs as an unfair trading practice, providing ample justification for NAFTA to be reopened.

The purpose of this paper is to identify and gauge the relative importance of the factors that explain recent trends in Mexican imports of poultry from the United States. We explore several factors including the effects of tariffs under NAFTA, U.S. Government programs, and feed costs in both the

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<sup>2</sup> USDA, FAS, Global Agricultural Trade System, using data from the United Nations Statistical Office, retrieved Jan. 14, 2003.

<sup>3</sup> Servicio de Información y Estadística Agroalimentaria y Pesquera, SAGARPA.

<sup>4</sup> Agriculture directly employs about 20 percent of Mexico's workforce, yet contributes less than 5 percent to Mexico's GDP.

<sup>5</sup> Excelsior, Dec. 23, 2002, as reported in USDA, FAS, Mexico Agricultural Situation, Weekly Highlights & Hot Bites, Issues # 44, Gain Report # MX2174, Dec. 24, 2002.

<sup>6</sup> El Universal, Dec. 22, 2002, as reported in USDA, FAS, Mexico Agricultural Situation, Weekly Highlights & Hot Bites, Issues # 44, Gain Report # MX2174, Dec. 24, 2002.

<sup>7</sup> "Agriculture and Trade: Mexico at a Crossroads," conference hosted by Instituto Tecnológico de México (ITAM), Mexico City, Jan. 17, 2003.

<sup>8</sup> Ibid.

<sup>9</sup> The Farm Security and Rural Investment Act of 2002.

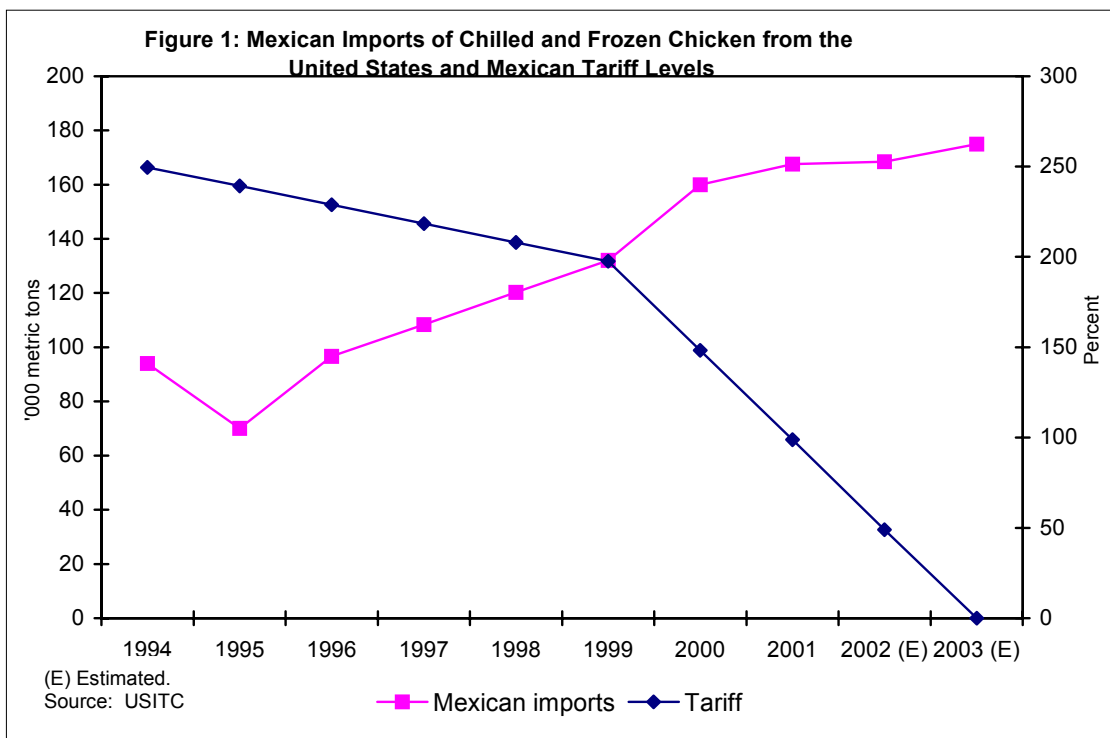
<sup>10</sup> "Agriculture and Trade: Mexico at a Crossroads," conference hosted by Instituto Tecnológico de México (ITAM), Mexico City, Jan. 17, 2003.

<sup>11</sup> "Economic and Policy Outlook for U.S./Mexico Bilateral Agricultural Relations," presentation by Undersecretary of Agriculture, J.B. Penn, Mexico City, Nov. 25, 2002.

United States and Mexico. We also evaluate other competitive factors influencing Mexican poultry production, such as Mexican Government payments to grain farmers, the structure of Mexico's poultry sector, and structural challenges facing the entire agricultural sector in Mexico. We include a brief discussion of the recent NAFTA safeguard imposed on U.S. exports of chicken leg quarters into Mexico. Finally, we comment on the potential for Mexico to become an exporting country of poultry meat to the United States.

### Trends in Mexican Tariffs and Imports of U.S. Poultry

Nowhere is pressure greater to renegotiate NAFTA than from the Mexican poultry sector. As shown in figure 1, Mexican tariffs dropped under NAFTA from 260 percent in 1994 to zero on January 1, 2003, with most of the reductions taking place since 1999 when poultry tariffs still remained at 200 percent. Meanwhile, Mexican imports of U.S. chicken increased from about 70,000 metric tons in 1995 to close to 170,000 metric tons in 2002, an annual increase of about 14 percent. Simply on the basis of these trends, it would appear that tariff reductions under NAFTA are part of the story in explaining growth in poultry imports.



### Impact of U.S. Farm Program

Mexican poultry officials have argued that as a result of the U.S. Government's price and income support of grain producers, U.S. poultry producers gain access to low-cost feed inputs that allow them to export to Mexico with an unfair advantage. Table 1 provides information on U.S. support for corn. In 2000 payments exceeded \$10 billion and in 2003 payments are expected to be almost \$5 billion. On average during 1998-2002, government payments represented about one-third of the farmgate price, reaching almost 60 percent of the price in 2000.

**Table 1**  
**U.S. Government support for corn, 1998-2003**

Item	1998	1999	2000	2001	2002	2003 <sup>(1)</sup>
Total government expenditure (\$ million) . . . . .	2,877	5,403	10,136	6,297	3,237	4,807
Production (million metric tons) . . . . .	234	248	240	252	241	229
Government expenditure per ton (\$/metric ton) . . . . .	12	22	42	25	13	21
Farmgate price (US\$/metric ton) . . . . .	96	76	72	73	78	94
Expenditure / farmgate price (percent) . . . . .	13	28	59	34	17	22

<sup>1</sup> Estimate.

Source: USDA, Farm Services Agency.

Do these payments explain the trends in Mexican poultry imports? More precisely, how much would Mexican imports of poultry drop in the absence of the U.S. corn program? This question can be broken down into three component questions. (1) How much would corn prices rise in the absence of the U.S. corn program? (2) How much would U.S. poultry costs of production rise with increases in corn prices? (3) How much would Mexican imports of poultry decline with increases in U.S. poultry cost of production?

Estimating what corn prices in the United States would be if there were no farm programs is problematic. Nonetheless, a recent study by the Economic Research Service of the U.S. Department of Agriculture estimated the impact of eliminating a program that provides payments to farmers when market prices fall below pre-determined, government-established prices.<sup>12</sup> This program, the “marketing loan program,” is the program that creates the largest market distortions in terms of providing farmers’ incentives to over-produce because payments are directly linked to market prices. While it is true that U.S. farmers receive payments through other government programs (for example, direct farm payments under the 2002 Farm Bill), such payments are decoupled from market conditions and are not believed to significantly alter farmers’ production and marketing decisions.<sup>13</sup> For example, there appears to have been no production response to the massive emergency payments provided to corn growers during 1998-2000 (table 1). The USDA study indicated that without the marketing loan program, the price of corn would rise, at most, by about 10 cents per bushel, while the price of soybeans would rise by about 50 cents per bushel. In both cases, the price increase is about 5 percent. If other programs are assumed to result in higher production and lower prices, prices of corn and soybeans might be expected to increase by at most 10 percent in the situation where no government support existed.

How would such corn and soybean price increases impact production costs in the U.S. poultry sector? A cost breakdown is shown in table 2. Based on 2002 data, the wholesale cost of producing one pound of chicken meat in the United States is about 48 cents, or \$1.06 per kilo.<sup>14</sup> This includes the cost of feeding the chicken to slaughter weight, as well as processing, marketing, transportation, and administration expenses. Of this 48 cents per pound, the cost of feed is roughly 15 cents per pound, so feed accounts for about one-third of the total cost of producing one pound of U.S. chicken meat. As stated earlier, prices of corn and soybeans would be expected to increase by 10 percent if there were no government payments. As shown in table 2, a 10 percent corn and soybean price rise means an increase in the total production cost of about 1.5 cents per pound to about 49.3 cents per pound, an increase of just

<sup>12</sup> Westcott, P.C., and J.M. Price, “Analysis of the U.S. Commodity Loan Program with Marketing Loan Provisions,” USDA, ERS, Report No. 801, Apr. 2001.

<sup>13</sup> Westcott, P.C., C. E. Young, and J.M. Price, “The 2002 Farm Act: Provisions and Implications for Commodity Markets,” USDA, ERS, Agricultural Information Bulletin Number 778, Nov. 2002.

<sup>14</sup> Salin, D.L., W.F. Hahn, and D.J. Harvey, “U.S.-Mexico Broiler Trade: A Bird’s-Eye View,” USDA, ERS, LDP-M-102-01, Dec. 2002.

**Table 2**  
**U.S. poultry: Cost of production components, 2002**

<b>Cost</b>	<b>Unit</b>	<b>2002</b>	<b>2002 + 10%<sup>1</sup></b>	<b>2002 + 20%<sup>2</sup></b>
Corn – Chicago	\$/bushel	2.29	2.52	2.75
Location differential - Production area	\$/bushel	0.45	0.45	0.45
Corn in production area	\$/bushel	2.74	2.97	3.20
Cost of corn <sup>3</sup>	\$/ton of ration	66.54	72.10	77.66
Soymeal – Decatur, 49%	\$/ton	168.81	185.69	202.57
Location differential - Production area	\$/ton	19.30	19.30	19.30
Soymeal in production areas	\$/ton	188.11	204.99	221.87
Cost of soymeal <sup>4</sup>	\$/ton of ration	48.91	53.30	57.69
Corn & soymeal - Production area	\$/ton	115.45	125.40	135.35
Adjustment for other ingredients	\$/ton	30.00	30.00	30.00
Milling & delivery cost	\$/ton	8.70	8.70	8.70
Total feed cost	\$/ton	154.15	164.10	174.05
Total feed cost	¢/ lb.	7.71	8.20	8.70
Feed cost per lb. of live bird <sup>5</sup>	¢/ lb.	15.41	16.41	17.40
Non Feed cost per lb. of live bird	¢/ lb.	10.35	10.35	10.35
Total cost per lb. of live bird	¢/ lb.	25.76	26.76	27.75
Meat cost – per lb. of ready to cook meat <sup>6</sup>	¢/ lb.	33.90	35.21	36.52
Processing & marketing costs per lb. of ready to cook meat	¢/ lb.	14.10	14.10	14.10
Total cost – per lb. of ready to cook meat	¢/ lb.	48.00	49.31	50.62
Feed cost / total cost ready to cook meat	%	32.1	33.3	34.4
Increase in total feed cost	%	0.0	2.7	5.5

<sup>1</sup> Cost of production assuming a 10 percent increase in corn and soybean meal prices.

<sup>2</sup> Cost of production assuming a 20 percent increase in corn and soybean meal prices.

<sup>3</sup> Assumes 35.7128 bushels per metric ton, and 68 percent corn in ration.

<sup>4</sup> 26 percent soybean meal in ration.

<sup>5</sup> Assumes a conversion ratio of 2 pound of feed per pound of meat.

<sup>6</sup> Assumes a dressing percentage of 76. That is, every pound of meat is equivalent to 1.76 pounds of live bird.

Source: Authors estimates, based on information from the Economic Research Services, U.S. Department of Agriculture.

less than 3 percent. As an extreme case, we assumed corn and soybean price increase by 20 percent in the absence of U.S. farm programs. In this case the overall cost of production for chicken meat increased by less than 6 percent.

Finally, how much would Mexican poultry imports fall with the increase in cost of production? The answer to this question requires an understanding of the characteristics of demand for poultry in the United States and Mexico. There is well-documented evidence that U.S. consumers prefer breast (or white) meat over drumsticks, thighs and wings (dark meat).<sup>15</sup> This has resulted in considerable price differences between white meat and dark meat in the United States. These price differences are demonstrated in table 3, which compares prices for white and dark meat in the United States and Mexico.

<sup>15</sup> Ibid.

**Table 3**  
**Wholesale chicken prices in the United States and Mexico City**

Location	Breast meat	Leg quarter	Leg quarter prices as percent of breast meat prices
	Cents ( <i>per pound</i> )		Percent
United States:			
Midwest U.S. ....	75	19	25
Southern U.S. ....	73	16	22
Northeast U.S. ....	75	19	25
Mexico City:			
Rayon .....	113	75	66
San Juan .....	117	75	64
New San Juan .....	117	80	68
Becerra .....	122	80	66

Source: Agriculture Marketing Service, U.S. Department of Agriculture, "Poultry Market News," U.S. regional prices for month of Jan. 2003 and Mexico City prices for week ending Jan. 24, 2003.

As shown, white meat sells for a considerable premium compared to dark meat in all parts of the United States. Despite the significant price premium for white meat, U.S. consumers continue to prefer white meat. To meet this demand U.S. producers produce 14 million metric tons of chicken per year.<sup>16</sup> However, white and dark meat is necessarily produced in a fixed proportion; there are no all-white meat chickens. As a result, U.S. processors are left with a surplus of dark meat.

It is at this point that the differences in consumer demand between Mexico and the United States become important. Mexican consumers have traditionally preferred dark meat to white meat. This has resulted in a market that in some important ways is the mirror image of the U.S. market. As table 3 shows, the preference for dark meat in Mexico has resulted in dark meat commanding prices that are much closer to white meat. Further, table 3 highlights the significant price differences for dark meat in the United States and Mexico. As a result of these differing consumer preferences and the resulting price differences, Mexico offers a complementary market for U.S. poultry producers. U.S. processors, who hold an excess supply of dark meat, therefore must choose between selling this product in the U.S. market at very low prices or exporting to the Mexican market at considerably higher prices. These conditions create powerful incentives for U.S. processors to export to Mexico.

Most importantly, the very large price differences between the U.S. and Mexican dark meat markets would allow U.S. producers not only to overcome higher grain prices with no U.S. farm program, but also to overlook very high tariffs. For example, assuming that in the absence of U.S. farm programs, feed costs increase by 20 percent and total costs by 5 percent, the no program scenario might raise the cost of U.S. chicken leg quarters from \$0.20 cent pound to \$0.21 cents per pound, while a Mexican tariff of 100 percent would raise this price from \$0.21 to \$0.42 per pound. This price is still considerably below the average Mexican price of \$0.75-\$0.80 per pound. Therefore, even in the face of higher production costs and significant tariffs, U.S. producers would find it highly profitable to export to Mexico.

### **Analysis of Feed Costs in Mexico**

Our analysis indicates that the primary reason for Mexican imports of U.S. poultry is the huge retail price differential for processors of chicken parts between the two markets. However, feed costs in Mexico are also part of the story. Although data on Mexican feed grain prices are not available, it appears

<sup>16</sup> Livestock, Dairy, and Poultry Outlook, ERS, LDP-M-102, Dec. 2002.

that Mexican poultry producers face higher feed costs than their U.S. counterparts.<sup>17</sup> This cost difference is not because of the U.S. farm programs, but rather because of high prices of Mexican imported corn and low availability of domestically produced corn and other feed grains for the Mexican poultry sector.

Given the relative size and proximity of the U.S. market, the price of imported corn in Mexico is the U.S. price plus the tariff, plus the transportation cost of moving product from the United States to Mexico. Under NAFTA, Mexico maintains a tariff-rate quota (TRQ) on imports of corn from the United States. In-quota tariff rates are low, 1 percent to 2 percent. However, over-quota rates are prohibitive and in 2003 the over-quota rate is 91 percent. Licenses to import at the low in-quota tariff are allocated by the Mexican Government on an industry basis (such as livestock and starch industries).<sup>18</sup> Although traditionally the livestock sector has received about 50 percent of the in-quota imports, there are indications that this still does not provide a large enough supply to result in prices comparable to those of U.S. poultry producers.<sup>19</sup>

Mexican poultry producers rely heavily on imported feed grains and nearly one-half the feed grain available to the livestock sector is imported from the United States.<sup>20</sup> As a result, the prevailing price in half the feed grain market is the U.S. price delivered to Mexico, which includes tariffs and transportation costs. The transportation differential, the cost to ship feed grain from the United States to Mexico, is not born by U.S. poultry producers, who instead face much lower transportation costs because they are closer to their feed grain supply. The high delivered price for imported grains also permits Mexican feed grain producers to receive a higher price because they can sell at prices comparable to the U.S. delivered price. This results in higher feed grain costs for Mexican producers. Additionally, a less efficient transportation system in Mexico, as compared with the United States, increases the cost of distributing the feed, corn, or sorghum. Less developed transportation infrastructure in Mexico also increases the cost and time required to deliver feed grain.<sup>21</sup>

In addition to tightly controlled imports, domestically produced supplies of yellow corn appear inadequate. A comparison of U.S. and Mexican corn sectors is shown in table 4. These data demonstrate the vast differences in scale and productivity between U.S. and Mexican corn farmers. U.S. farmers plant almost four times the area and get better than three times the yield of their Mexican counterparts. Thus, the total supply of feed for each country's poultry industry is vastly different, with U.S. producers having access to a considerably larger supply.

The supply of feed grains in Mexico is from domestic production and imports of both corn and sorghum.<sup>22</sup> However, the vast majority of Mexican corn production is white corn for human consumption.

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<sup>17</sup> Foreign Agriculture Service, U.S. Department of Agriculture, "Mexico Poultry and Products Annual 2002," Sep. 4, 2002; Mexican Secretariat of Agriculture (SAGARPA), "Structure of the Swine and Poultry Industries in Mexico," 2002, and author's interviews with Mexican producers.

<sup>18</sup> Foreign Agriculture Service, U.S. Department of Agriculture, "Mexico Grain and Feed, Mexican Government Announces New Corn Import Certificates 2002," Sep. 4, 2002.

<sup>19</sup> Foreign Agriculture Service, U.S. Department of Agriculture, Mexico Poultry and Products Annual 2002," Sep. 4, 2002; Mexican Secretariat of Agriculture (SAGARPA) "Structure of the Swine and Poultry Industries in Mexico," 2002; and Economic Research Service, U.S. Department of Agriculture, "Feed Situation and Outlook," Apr. 2002.

<sup>20</sup> Foreign Agriculture Service, U.S. Department of Agriculture, "Mexico Grain and Feed Annual," Mar. 12, 2002, and "Mexico Grain and Feed, Sorghum and Corn Update," Nov. 5, 2002.

<sup>21</sup> Authors' interviews with Mexican poultry producers.

<sup>22</sup> Mexican Secretariat of Agriculture (SAGARPA) "Structure of the Swine and Poultry Industries in Mexico," 2002, Foreign Agriculture Service, U.S. Department of Agriculture, "Mexico Grain and Feed Annual," Mar. 12, 2002, and "Mexico Grain and Feed, Sorghum and Corn Update," Nov. 5, 2002.



**Table 4**  
**Comparison of U.S. and Mexican corn sectors, 2001**

<b>Item</b>	<b>Mexico</b>	<b>United States</b>
Production (million metric tons) . . . . .	20.4	252
Area (million hectares) . . . . .	7.8	29.3
Yield (tons per hectare) . . . . .	2.6	9

Source: U.S. Department of Agriculture.

Less than 1 percent of Mexican corn production is yellow corn for livestock feed.<sup>23</sup> Based on 2002, a total of 13.6 million metric tons of feed were available to the entire Mexican livestock sector (consisting of 5.6 million metric tons of Mexican sorghum production, 4.4 million metric tons of sorghum imports, 3.5 million metric tons of yellow corn imports, and 200,000 tons of Mexican yellow corn production). Data from the Mexican Poultry Producers Association (UNA) indicate that the Mexican poultry industry requires approximately 7.6 million metric tons of feed grain, while the pork industry has an annual feed need of about 4.5 million metric tons.<sup>24</sup> On the basis of these estimates, Mexico’s other livestock industries, specifically the beef and dairy industries would have only 1.5 million metric tons of feed available. This demonstrates the tightness of feed grain availability in Mexico, owing to growing demand from the livestock sector at a time when additional supplies of corn from imports are subject to extremely high tariffs.

### **Other Factors to Consider**

The Mexican Government provides assistance to farmers, especially to its corn farmers. There are two main support programs and some additional smaller programs.<sup>25</sup> The largest program is PROCAMPO which pays a fixed amount per hectare; for the current crop year the payment is 905 pesos. Current forecasts are that Mexico will harvest approximately 8 million hectares this crop year.<sup>26</sup> This equates to total payments of approximately 7.2 billion pesos (roughly \$700 million). The second program is provided through the Support Services for Agricultural Marketing Agency (ASERCA) and consists of a payment per metric ton of corn.<sup>27</sup> The payment amount and the tons of crop eligible vary by state. For example, during the last crop year the ASERCA program in the Chiapas paid 270 pesos per ton for white corn and 380 pesos per ton for yellow corn. In Chihuahua the payments were 180 pesos per ton for white corn and 220 pesos per ton for yellow corn. In these two states, payments were made for 872 thousand tons of corn for a total expenditure of approximately 212 million pesos (or \$21 million).<sup>28</sup> The Mexican Government also provides some assistance to offset transportation costs from the farm to the city and has provided export subsidies on white corn to draw down high inventory levels.<sup>29</sup> It is important to note,

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<sup>23</sup> Authors’ interviews with staff of the U.S. Grains Council and Foreign Agricultural Services, U.S. Department of Agriculture.

<sup>24</sup> Foreign Agriculture Service, U.S. Department of Agriculture, “Mexico Poultry and Products Semi-Annual 2003,” Jan. 27, 2003, and Mexican Secretariat of Agriculture (SAGARPA) “Structure of the Swine and Poultry Industries in Mexico,” 2002.

<sup>25</sup> OECD, “Agriculture Policy in OECD Countries Monitoring and Evaluation 2002,” Jan. 2003, USITC staff interviews with FAS staff, and ASERCA.

<sup>26</sup> Foreign Agriculture Service, U.S. Department of Agriculture, “Mexico Grain and Feed Sorghum and Corn Update,” Nov. 5, 2002.

<sup>27</sup> OECD, “Agriculture Policy in OECD Countries Monitoring and Evaluation 2002,” Jan. 2003, USITC staff interviews with FAS staff, and ASERCA.

<sup>28</sup> Provided by Foreign Agriculture Service, U.S. Department of Agriculture, originally published in *Diario Oficial*, Government of Mexico.

<sup>29</sup> Authors’ interviews with staff of the U.S. Grains Council and Foreign Agricultural Services, U.S. Department of Agriculture.

however, that there are reports that not all farmers eligible for the payments receive them.<sup>30</sup> Also, Mexico has a significant number of what can be called tenant farmers who work land they do not own. Payments through the PROCAMPO program and perhaps other programs are received by the landowner, not the farmer.<sup>31</sup>

Mexico's poultry industry has been the fastest growing sector of Mexico's livestock industry. Between 1990 and 2001, Mexico's poultry production grew at an annual average rate of almost 9 percent.<sup>32</sup> This growth rate was fairly constant both before and after NAFTA. If this is the case, why are imports such a concern? The likely answer is that Mexico's poultry industry is highly concentrated, with the top three producers—Bachoco, Pilgrim's Pride, and Tyson accounting for 52 percent of the market, while the top ten producers account for 67 percent of the market.<sup>33</sup> The remaining market share is held by a larger number of smaller firms. This would appear to indicate that problems in Mexico's poultry industry do not stem from NAFTA or U.S. farm payments, but that the benefits of production growth are not being distributed among all sections of the Mexican poultry industry.

Another key issue is that Mexico's policies and institutions discourage the gains of increased productivity and trade from being distributed evenly within agriculture.<sup>34</sup> For example, the Ejido system of land tenure (commonly held land) still persists in many parts of Mexico which results in land fragmentation and uneconomic farm sizes. The lack of land ownership by farmers operating the Ejido land means that land cannot be used as collateral for loans and as a result investment and productivity are low.<sup>35</sup> In general, rural credit is expensive, making it impossible for small farmers to expand operations. Weak banking and legal systems have also been identified as contributing to the structural problems of Mexican agriculture. Banks often impose highly restrictive collateral requirements, while the legal system is not sufficiently strong to enforce payment requirements and to allow lenders to obtain collateral in cases of loan default. The land ownership and inadequate banking and legal systems mean that foreign direct investment in Mexican agriculture by small to medium U.S. firms have been discouraged. Other problems facing Mexico's agricultural producers include a poor transportation system and the lack of cold chain infrastructure. Both these factors particularly increase the costs of marketing and distributing fresh and chilled products throughout the country. The use of state-of-the-art technology in food production and processing is also limited to a relatively small number of operations, and most production equipment in Mexican agriculture is out-moded. Other factors negatively impacting Mexico's agricultural competitiveness include poor water quality, lack of biotechnology policy, lack of agricultural education and extension, and poor market information and statistical reporting.<sup>36</sup>

### **Safeguards Under NAFTA**

NAFTA allows participating countries to increase tariffs to MFN rates if, as a result of tariff reductions, imports increase to levels that cause (or threaten to cause) harm to the domestic industry producing similar products.<sup>37</sup> NAFTA safeguards, are designed to provide temporary relief (a maximum

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<sup>30</sup> Authors' interviews with Mexican farm organizations and ITAM conference.

<sup>31</sup> Ibid.

<sup>32</sup> Mexican Secretariat of Agriculture (SAGARPA) "Structure of the Swine and Poultry Industries in Mexico," 2002.

<sup>33</sup> Ibid.

<sup>34</sup> "Economic and Policy Outlook for U.S./Mexico Bilateral Agricultural Relations," presentation by Undersecretary of Agriculture, J.B. Penn, Mexico City, Nov. 25, 2002.

<sup>35</sup> USDA, ERS, "Mexico. Briefing Room. Basic Information," Dec. 12, 2002.

<sup>36</sup> "Economic and Policy Outlook for U.S./Mexico Bilateral Agricultural Relations," presentation by Undersecretary of Agriculture, J.B. Penn, Mexico City, Nov. 25, 2002.

<sup>37</sup> USDA, FAS, NAFTA Agriculture Factsheet, Special Agricultural Safeguard Provision, Jan. 1998.

of 3 years) from imports and requires that compensation be made to the supplying country, usually in the form of lower tariffs on other U.S. exports into Mexico. Late last year, UNA requested that the government place a safeguard on U.S. chicken leg quarters.<sup>38</sup> This led to the start of an investigation by the Mexican Government to determine whether such a safeguard is justified under NAFTA rules. The result of the investigation is expected mid 2003. However, as an interim measure, Mexico recently imposed a provisional safeguard, in which Mexico agreed to allow 50,000 metric tons of U.S. chicken leg quarters into the Mexican market with a zero tariff. Imports over the 50,000 metric ton limit would face a tariff of 98.8 percent.<sup>39</sup>

The U.S. poultry industry agreed to this deal partly because it feared continued use of non-scientific testing requirements.<sup>40</sup> Since June 2002, U.S. poultry has been effectively banned following Mexico's introduction of new Avian Influenza testing requirements that U.S. producers were not able to meet. Similarly, last month Mexico banned all U.S. poultry products (except cooked meat) following an outbreak of Exotic Newcastle Disease (END) in California.<sup>41</sup> Although the disease was confined to California, product from all 50 U.S. states was banned. There was also concern by U.S. exporters that, if no deal were struck, U.S. product would inevitably become subject to antidumping duties. The hope of U.S. poultry interests is that with the safeguard, all illegitimate trade issues will go away and only duties affect trade.<sup>42</sup> Although the safeguard action is not a desirable development, it may be better than the alternatives: technical trade barriers, additional duties, and at worst, a renegotiation of NAFTA.

### **Potential of Mexico's Poultry Exports to the United States**

At the beginning of this article, we commented on the overall impact of NAFTA on Mexico. Mexico currently runs a sizeable trade surplus with the United States, and 80 percent of Mexico's agriculture exports are to the United States. Why then has the Mexican poultry industry not been able to take advantage of NAFTA for its benefit? Certainly, higher feed costs, smaller companies, and consumer characteristics play a significant role in the inability of Mexico to export poultry to the United States. In addition, Mexico lacks the regulatory approval needed from the U.S. Government to export to the United States.<sup>43</sup>

In order to export fresh poultry to the United States, Mexico must first ensure U.S. authorities that the poultry is produced in states considered low risk for END, a particularly virulent poultry disease.<sup>44</sup> At this time, only Sinaloa and Sonora have been certified as low risk for END.<sup>45</sup> However, the Mexican Government continues to work towards eliminating the disease. Additionally, Mexican poultry plants must be certified by U.S. authorities that their standards of health and safety are equivalent to those in the United States. Plants in Sinaloa and Sonora are working on obtaining this certification. If Mexican poultry producers can successfully control or eliminate END and meet the other sanitary requirements to

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<sup>38</sup> USDA, FAS, "Mexico. Poultry and Products. Investigation on Bilateral Poultry Safeguards on Chicken Leg Quarters," Gain Report # MX2166, Dec. 5, 2002.

<sup>39</sup> Office of the U.S. Trade Representative, "U.S. Works to Secure Poultry Exports to Mexico," Press Release, Jan. 23, 2003.

<sup>40</sup> Comments by Jim Sumner, President of the U.S.A. Poultry & Egg Export Council, Wall Street Journal, Dec. 20, 2002.

<sup>41</sup> USDA, FAS, Mexico. "Mexico. Poultry and Products. Poultry Banned due to Exotic Newcastle Disease," Gain Report # MX3007, Jan. 13, 2003.

<sup>42</sup> Comments by Bill Roenigk, Vice President National Chicken Council, Associated Press, Jan. 1, 2003.

<sup>43</sup> Salin, D.L., W.F. Hahn, and D.J. Harvey, "U.S.-Mexico Broiler Trade: A Bird's-Eye View," USDA, ERS, LDP-M-102-01, Dec. 2002.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid.

obtain permission to export to the United States, the current status of the industry could change dramatically.

When Mexico's poultry producers receive permission to export to the United States, they will have access to a huge market. With access to cheaper feed, the large, modern Mexican producers would then be operating on a level playing field. The factors that make Mexico a complementary export market for U.S. producers could also make the United States a complementary export market for Mexican producers. The dynamics of the Mexican poultry industry could therefore change dramatically.

### **Conclusion**

Based on the analysis we provide for poultry, neither favorable tariff treatment under NAFTA, nor government payments are sufficient reasons to explain growth in poultry imports from the United States. Poultry production in Mexico increased sharply in recent years during the same period that imports grew. We argue that two factors harm Mexican producers, factors that are internal to Mexico's agricultural sector and which can only be changed by reforming Mexico's domestic agricultural policy. First, Mexico's support for its feed grain sector, which includes high tariffs and import quotas on corn, makes the cost of feed artificially high to Mexico's poultry producers. Second, Mexico's policies and institutions discourage the gains of increased productivity and trade from being distributed evenly within agriculture. Lack of rural credit, poor marketing and distribution, issues of land tenure and farm size, and access to affordable agricultural inputs, are among key institutional and structural problems that adversely affect Mexico's competitiveness in poultry vis-à-vis the United States.