Western Hemisphere Trading Blocs and Tariff Barriers for U.S. Agricultural Exports

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Abstract

We examine the tariff structure of recent western hemisphere trade agreements which have excluded the United States, and discuss how they may be favorable or unfavorable to third-country agricultural exporters such as the United States. The MERCOSUR agreement, which includes the two largest economies in South America, namely Brazil and Argentina, has introduced the most favorable trade regime vis-a-vis third-country agricultural exporters of any of the agreements examined. The other agreements examined—the Andean Pact, the Central American Common Market (CACM), and Chile's numerous Economic Complementarity Agreements—are more problematic for third-country exporters. The Andean Pact and the CACM have adopted common external tariffs with escalating tariffs in agriculture. Chile's numerous bilateral agreements give preference to U.S. competitors in the Chilean market.

Introduction

In recent years, a considerable number of regional trade agreements (RTA's) that do not include the United States have been established in Central and South America: Mercado Comun del Sur (MERCOSUR), the Andean Pact, the Central America Common Market (CACM), the Caribbean Common Market (CARICOM) and the G-3 agreement among Venezuela, Colombia, and Mexico. In addition, Chile has established its own agreement with MERCOSUR, as well as a long list of other bilateral agreements. In fact, every major country in Central and South America is a party to at least one regional or bilateral trade agreement (see map on following page).

Agriculture has often been a particularly sensitive area of negotiation in these agreements, and there is some concern that disadvantages to third-country agricultural exporters such as the United States have been intentionally or unintentionally introduced by these agreements.

In a free trade area, preferential tariffs are granted to members of the agreement and tariffs on third-country exports remain unchanged. Free trade areas offer few potential benefits for outside countries and are disadvantageous in several respects. The most fundamental concern of third-country exporters is that they face stiffer competition with suppliers from within the bloc whose exports now enjoy a preferential tariff rate, which forces price reductions and/or sales reductions (trade diversion). Formation of a free trade area allows

Main RTA's in the Western Hemisphere

member countries to keep tariffs high for third-country exporters; in a free trade area there is no need for negotiation and compromise around a common external tariff (CET) as in a customs union.

When one country is simultaneously a member of several free trade areas, this raises additional concerns. Transshipment schemes may be set up to circumvent additional tariffs to the further disadvantage of third-country exports. Of course, rules of origin that establish the conditions under which products are to be eligible for free trade help reduce the impact of this effect, but the documentation requirements that accompany the rules of origin regulations also introduce a new set of transaction costs that must be borne by all exporters.

Customs unions tend to be less disadvantageous for third-country exporters. Customs unions grant preferential tariffs to members of the agreement but also change third-country tariffs by establishing a common external tariff (CET). In most cases, tariffs are reduced in the CET; thus there may be improvement, or at least less deterioration, in third-country export prospects. GATT Article XXIV stipulates that, in establishing the CET, no member of the agreement may raise its *overall* tariff level. In spite of this provision, the possibility remains, however, that certain tariffs may remain high or even be raised by the CET, so long as other tariffs are reduced enough to lower the overall average.

Even though the CET tariff structure of a customs union must reduce overall tariff levels to comply with WTO provisions, countries may sometimes skew the structure of the new tariff regime in the pursuit of domestic objectives. One common example of this is the case of tariff escalation, in which countries strive to protect value-added industries by allowing imports of raw and unprocessed primary products at extremely low tariff rates but charge higher rates on further processed products, a scheme which can severely constrain imports of processed products.

All of the potential problems described above are present in recent agreements in the western hemisphere. The most significant free trade areas which exclude the United States are Chile's bilateral agreements and the G-3 agreement between Mexico, Colombia, and Venezuela; the most significant customs unions are MERCOSUR, the Andean Pact, and the CACM. This paper examines the impact of these agreements on tariffs faced by third-country agricultural exporters such as the United States.

MERCOSUR

From the standpoint of U.S. agriculture, the most significant RTA in the Western Hemisphere other than NAFTA is the MERCOSUR agreement among Argentina, Brazil, Uruguay, and Paraguay.

The formation of MERCOSUR on January 1, 1995, marked the culmination of a process that entailed a significant reduction in tariffs faced by agricultural products. MERCOSUR established a CET ranging from 0-20 percent for products coming from third countries and a zero-percent tariff for products traded within the bloc (with a few exceptions).

Free trade agreement talks between Argentina and Brazil began in earnest in the early 1980's, and both countries have been making strides toward harmonization of their respective tariff regimes since at least the mid-1980's. Finally, in 1991, Argentina, Brazil, Paraguay, and Uruguay signed the Treaty of Asunción, formally creating MERCOSUR, and agreeing that the common market would be established by December 1994 for Argentina and Brazil and by 1995 for Uruguay and Paraguay.

Figure 1 shows Argentina's applied tariffs on agricultural products in 1987, about the time of the beginning of discussions with Brazil of the formation of MERCOSUR. As can be seen from the graph, Argentina imposed significant tariffs across a wide range of agricultural products. Tariffs ranged from 0 to 38 percent ad valorem, with about half of the agricultural products facing a tariff above 20 percent and the other half below 20 percent. Higher tariffs tended to be charged on processed products such as meat, animal offal or animal blood sausages, prepared or preserved fish, crustaceans and mollusks, chocolate, and other food preparations, with all of these products facing a tariff above 30 percent. The average tariff rate in 1987 was 20 percent.

Figure 3 shows Brazil's applied tariffs on agricultural products in 1986. Brazil's tariffs were much higher than Argentina's, ranging from 0 to 105 percent ad valorem, with most products facing a tariff above 40 percent. As in Argentina, higher tariffs tended to be charged on processed products such as prepared or preserved meat or meat offal, prepared or preserved fish, crustaceans and mollusks, prepared or preserved vegetables and fruits, beer, grape must, and wine made from fresh grapes, with all of these products facing a tariff above 100 percent. The average tariff rate in 1986 was 58 percent.

Figures 2 and 4 show CET tariffs applied to countries outside MERCOSUR such as the United States as of 1995. By the time the MERCOSUR agreement went into effect in 1995, Argentina and Brazil had lowered their average applied tariff levels by 50 and 82 percent, respectively. Argentine tariffs on consumer-oriented agricultural products such as dairy products, processed fruits and vegetables, and fruit and vegetable juices, among others, ranged from 20 to 38 percent during the 1980's. In 1995, when MERCOSUR went into effect, tariffs on these products dropped to an average of 14 percent. In Brazil these products had faced a tariff above 100 percent, but in 1995 the average tariff faced by these products went down to 16 percent with the establishment of MERCOSUR.

Recently (December 1997), in response to trade concerns arising from the Asian financial crisis, the MERCOSUR countries agreed to allow a temporary 3-percent increase in tariffs on most products in the CET. Given MERCOSUR's track record of success in negotiating considerable reductions in tariffs, it seems likely that this measure will prove to be temporary and will be removed on or before the year 2000 as has been promised.

The MERCOSUR trading bloc is also important because of its potential to expand to include additional members from the rest of the American continents and to negotiate with such powers as the European Union.

MERCOSUR has signed a bilateral agreement with Chile (see below), and another one with Bolivia, making these two countries associate members of MERCOSUR. The Bolivia-MERCOSUR Economic Complementarity Agreement (ECA) went into effect January 1, 1997. It anticipates the eventual formation of a free trade area between Bolivia and the MERCOSUR countries in 10 years through a gradual tariff elimination process.

After Bolivia became an associate member of MERCOSUR, the rest of the Andean Pact became interested in signing a bilateral agreement with MERCOSUR, and talks and negotiations are on the way to establish a MERCOSUR-Andean Pact agreement.

The MERCOSUR group is also having talks with Mexico to see if a bilateral agreement between these two parties would be possible.

Chile's Regional Agreements

Chile has been notable for its more advanced and freer trade policies in comparison with other Latin American countries. In 1988, Chile's tariffs were reduced from 26 percent to 15 percent, and in 1990, when democratic government resumed, tariffs were slashed further to 11 percent. It is due to its freer trade policies that Chile has pursued signing bilateral agreements rather than joining RTA's. If it were to join an RTA in the Western Hemisphere, Chile would be required to raise its low tariffs to the CET set by the RTA.

Chile's need for export markets led to the negotiation of the ECA with MERCOSUR, five bilateral ECA's

Figure 1--ARGENTINA 1987 Applied Tariffs

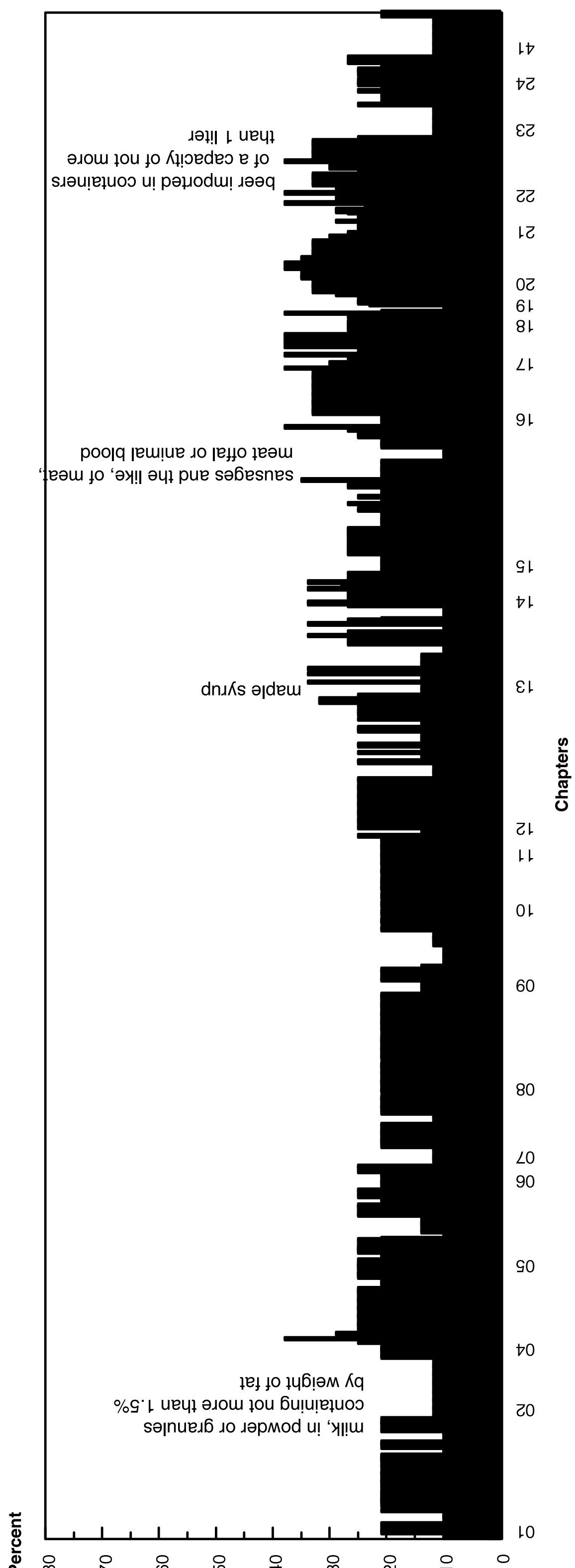


Figure 2--ARGENTINA 1995 Applied Tariffs

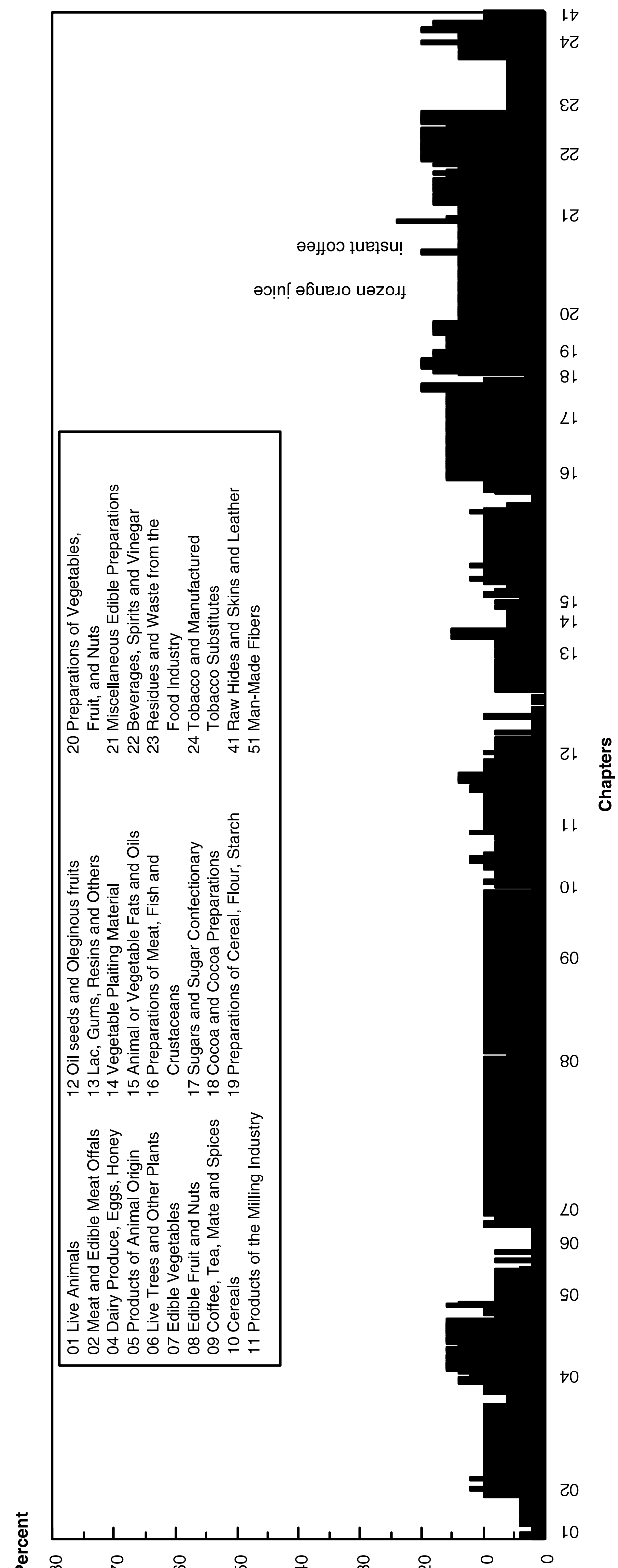


Figure 3--BRAZIL 1986 Applied Tariffs

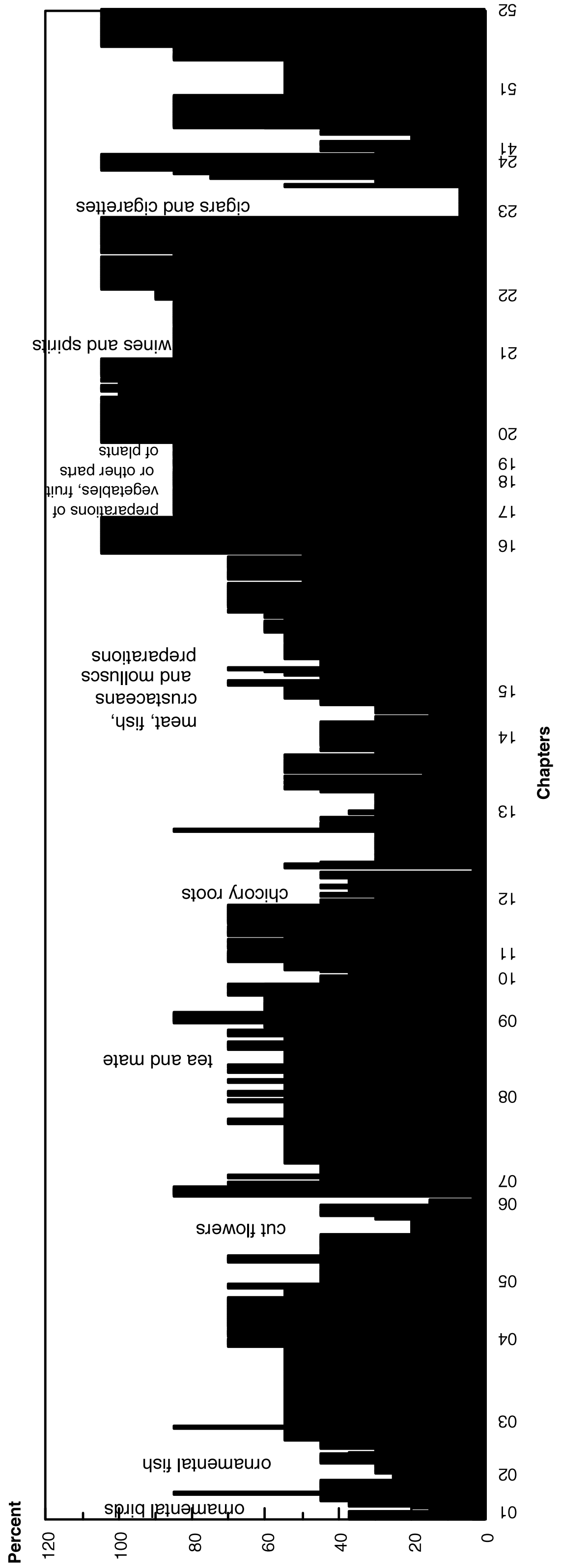
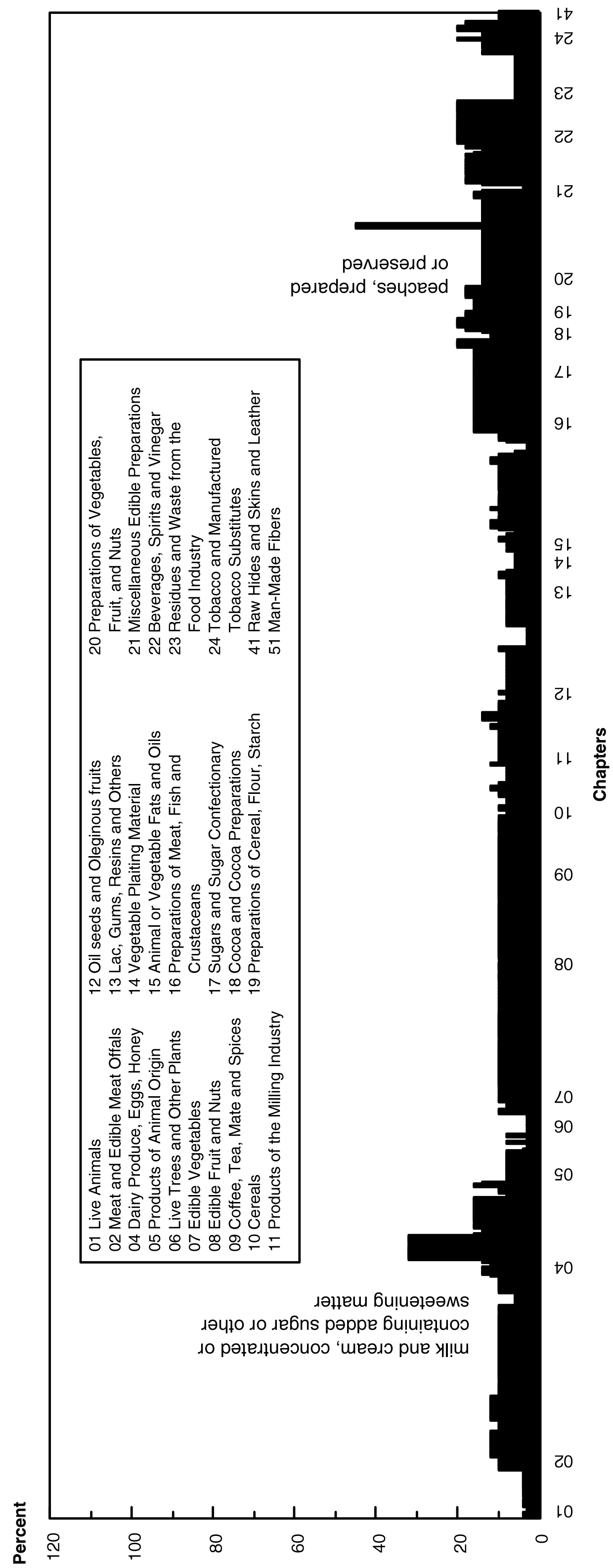


Figure 4--BRAZIL 1995 Applied Tariffs



with other Latin American countries (Mexico (1992), Venezuela (1993), Bolivia (1993)[1], Colombia (1994), and Ecuador (1995)), and a very recent agreement with Canada (1997).

These agreements lower tariffs on trade among the parties and eliminate many nontariff barriers but have no effect on tariffs faced by third countries such as the United States. The biggest U.S. agricultural concern regarding Chile's bilateral agreements is with regard to the recent agreement with Canada. As a result of this agreement, Canada enjoys more favorable tariff rates than the United States for such products as wheat, vegetable oil, and potatoes.

Another U.S. concern regarding the multiple and overlapping set of agreements that have been entered into by countries like Chile,[2] is that schemes may be set up to use this criss-crossing of agreements to "unfair" advantage. It is conceivable, for example, that processing may be set up in Chile for products that use some freely imported inputs from Canada, and some domestic Chilean inputs to produce products that qualify for tariff-free status for export to MERCOSUR. Wheat or potatoes, for example, might be imported by Chile from Canada (or Bolivia, or Peru, etc.), processed and packaged as bread or as french fries, and then exported into lucrative MERCOSUR markets. Of course, all agreements contain domestic-content requirements that somewhat restrict the wholesale avoidance of all duties through such arrangements, but some potential for loss of U.S. market opportunities due to existence of such strategies inevitably remains.

[1]Chile's agreement with Bolivia does not establish a free trade area, but rather involves partial trade liberalization with relative reciprocity and cooperation in the area of energy.

[2]Another example is the G-3 agreement between Venezuela and Colombia, which are also members of the Andean Pact, and Mexico, which is also a NAFTA member.

The ECA between Chile and MERCOSUR went into effect on October 1, 1996. It provides for the gradual elimination of mutual trade barriers, but does not require Chile to adopt MERCOSUR's *higher* Common External Tariff. Chile's uniform 11 percent tariff rate continues to apply to all third-country agricultural products except vegetable oils, sugar, wheat, and wheat flour, which are under price band mechanisms.

The ECA will eventually phase out all tariffs on trade between Chile and MERCOSUR countries according to a schedule consisting of four product categories: "general" with tariffs reaching zero by the year 2004; "sensitive" with tariffs phasing to zero by the year 2006; "especially sensitive" with tariffs phasing to zero by the year 2008; and "major sensitivity." Many agricultural products fall in the category of "major sensitivity" for which tariff reduction will not begin until 2006. Tariffs on these products will be phased down to zero over 5 years, beginning in 2006. Some of Chile's "major sensitivity" products are wines, raisins, apples, fresh grapes, and ice cream, and for MERCOSUR, soybean oil, sunflower oil, boneless meat, soybean cake, and rice (for more details on Chile's regional trade agreements see USDA, 1996 in references).

The Andean Pact

The Andean Group was first established in 1969 with Bolivia, Colombia, Ecuador, Peru, and Venezuela as its members. The agreement was not very effective in the early years, but in the early 1990's the Group members decided to revive and implement the policies created under the Andean Pact. A CET was designed which consists of four levels of tariffs: 5, 10, 15, and 25 percent. But Bolivia has requested and been granted permission to apply only two tariff rates of 5 percent and 10 percent, and Peru, currently engaged in a dispute over the CET, has left the group temporarily and is applying only two tariff rates—15 percent and 25 percent. Therefore, the only countries of the group applying the CET rates are Colombia, Ecuador, and Venezuela.

The agreement has four annexes with Annex I establishing the tariff levels for all traded goods; this is the main list of products applying the CET. Annex II lists those products from Annex I for which Ecuador is permitted to charge a tariff rate 5 percentage points lower. Annex III contains a short list of health and education products that may enter all three countries duty-free. Annex IV lists all those products for which each country has requested special treatment with respect to the tariff levels indicated in the CET (exceptions). Ecuador has 400 products in this list, Colombia and Venezuela over 200. However, each country has agreed to reduce its list of exceptions each year, with the objective of eliminating Annex IV within a 4-year period ending in 1999.

One aspect of the Andean Pact agreement of concern to third-country exporters is the tendency of the CET structure to be disadvantageous to processed products. In contrast to the MERCOSUR agreement, which has less tendency to protect agricultural processed products in its CET structure than had existed previously under individual countries' tariff schedules, the Andean Pact has been criticized for establishing a CET that has steeply escalating tariffs for processed products (Tavares de Araujo, 1995). A basic tenet of the Andean Pact CET schedule is to apply low (5 percent) tariffs on raw materials, with progressively higher rates for value-added industries as follows: 10 percent for basic inputs, 15 percent for intermediate goods, and 20 percent for most final goods.

Using Ecuador as a representative country, Tavaros de Araujo calculates that the CET tariff structure translates into an effective rate of protection for Ecuador's food and beverage industry ranging from 23 percent for malt beverages and soft drinks to as high as 125 percent for flour products. Similar rates would be expected to apply for other Andean Pact countries since value-added coefficients are likely to be similar across countries.

Tariff escalation within the CET structure means that although the United States may enjoy the benefits of low tariffs and enhanced export opportunities for bulk commodities like wheat, corn, and soybeans, processed products and high-value products—that have provided the source of much of the U.S. export growth in regions like Asia in recent years—may not develop to their full potential in the Andean Pact countries.

A second area of concern regarding the Andean Pact tariff regime is its failure to abolish price bands. Price bands act as variable-rate surcharges, effectively setting a floor on the import price of third-country products. As a result of price bands, the United States and other third-country exporters will find their trade displaced by intra-Andean Pact trade whenever such trade can occur at less than the floor price. The products covered by price bands under the Andean Pact CET are palm oil, soybean oil, rice, sugar, barley, milk, corn, soybeans, wheat, chicken, and pork.

The Central American Common Market (CACM)

The CACM[3] was established in 1960 by El Salvador, Guatemala, Honduras, and Nicaragua and joined later in 1963 by Costa Rica. The agreement was not fully implemented due to political, military, and economic difficulties, and was revived in the early 1990's.

As with the CET of the Andean Pact, the CACM CET tariff structure tends to provide a high rate of protection for many of the processed products that the United States might seek to export. Exports of products like wheat, corn, and soybeans are not likely to be sharply reduced by tariffs on the order of 5-10 percent, but further-processed products from the United States will have difficulty competing with intermediate and final consumer products that use competitively priced primary products and CACM country processing facilities.

[3]Belize and Panama participate in CACM summits but not in regional trade integration.

In October 1993, the CACM presidents signed the Protocol to the General Treaty on Central American Economic Integration (known as the Guatemala Protocol) as an addition to the original treaty. The Guatemala Protocol allows greater commercial exposure and diminishes the protectionist nature of the original 1960 CACM agreement.

The agreement provides for free trade for goods originating within the region except for those products listed in Annex A of the agreement, and a Common External Tariff (CET) for products coming from third countries such as the United States, with some exceptions.

As with many other international trade negotiations, agricultural commodities are the most sensitive commodities under discussion within the CACM. This is not surprising, considering the importance of agriculture to the Central American region, where the low-income population depends on near-subsistence agricultural production for their livelihoods.

One of the main goals of the CACM nations today is to revise the list of products exempted from the agreement in order to eventually eliminate Annex A. If successful, Central America will one day achieve a full customs union. To date, these revisions have been very successful. In the early 1960's, Annex A included about 30 agricultural products, and special tariff rates and import quotas were negotiated on a bilateral basis among member countries. After the last revision of Annex A on September 1, 1995, only 7 agricultural products are still exempt from the Common External Tariff. This illustrates the continuing movement toward greater integration of the Central American Common Market.

For a limited number of agricultural commodities, complete liberalization does not appear likely over the next few years. One example of this is Costa Rica's dairy industry; another is in Honduras, which applies price bands on corn-based products.

The CET structure was significantly revised by the Guatemala protocol in 1993. The CET is composed of three parts. Section I lists products that share the CET—about 979 agricultural products can be found here. Section II shows products still under negotiation (including about 27 agricultural products), for which each country is allowed to maintain its own tariff rate. Section III lists Costa Rica's national tariff rates for sensitive products, with nine agricultural products.

The CET has four levels of tariff rates for products in Section I: 5 percent, 10 percent, 15 percent, and 20 percent. About half of the 979 agricultural products are subject to the highest 20-percent tariff rate. Most vegetables are subject to a 15-percent tariff. Products in Sections II and III that are not yet subject to the CET are subject to various tariffs.

Since February 1996, the Central American Common Market has been making efforts to fully harmonize tariffs and trade policy. One of its main goals is to reduce the CET levels on most finished goods to a ceiling of 15 percent and reduce tariffs on raw materials to zero. El Salvador has been the most determined to lower tariffs and Costa Rica one of the most reluctant. Under its economic liberalization program, El Salvador envisioned reducing tariffs, and it will do so independently of other CACM members. Costa Rica has said it will reduce its CET levels in a gradual manner starting in 1997. Honduras, Guatemala, and Nicaragua have not yet defined their respective time frames for reducing tariff levels. The separate CET reductions that each member country plans to implement individually will cause CACM members to temporarily apply different levels of the CET. The Secretary for Central American Economic Integration (SIECA) believes that full tariff harmonization and reduction could take 3 to 4 years.

Conclusion

We examined the tariff structure of the most significant Western Hemisphere trade agreements and discussed their impacts on tariff regimes faced by third-country agricultural exporters such as the United States.

The MERCOSUR agreement, which includes the two largest economies in South America, namely Brazil and Argentina, has introduced the most favorable trade regime vis-a-vis third-country agricultural exporters of any of the agreements examined. Although MERCOSUR does, of course, introduce tariff preferences for parties to the agreement, the CET, established in 1995, also represented a significant reduction in tariffs faced by third-country agricultural exporters. The recently enacted 3-percent increase in most MERCOSUR CET rates in response to the Asian financial crisis hopefully does not set a precedent, but rather represents a reasonable temporary measure in response to a very special set of circumstances.

The other agreements examined are more problematic for third-country exporters. Both the Andean Pact and the CACM CET's include steeply escalating common external tariff structures that are disadvantageous to processed products and high-value products from third-country exporters such as the United States. In addition, the Andean Pact's price band mechanism for certain important agricultural products restricts third-country exports in times of falling prices. Chile's numerous Economic Complementarity Agreements allow partner countries preferential tariff rates without reducing tariffs faced by third-country exporters such as the United States. This may prove particularly important to the United States, for example, with respect to the recent trade agreement between Chile and Canada.

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