STATEMENT

OF THE U.S. GRAINS COUNCIL

TO THE U.S. HOUSE COMMITTEE

ON AGRICULTURE

ON

THE ECONOMIC IMPACTS REGARDING

THE MODERNIZATION OF THE

NORTH AMERICAN FREE TRADE AGREEMENT

WITH CANADA AND MEXICO

JULY 26, 2017

Floyd D. Gaibler

Director, Trade Policy & Biotechnology

U.S. Grains Council

20 F Street NW, Suite 600
Washington, DC 20001
Phone: 202-789-0789
Fax: 202-898-0522
grains.org

Chairman Conaway, Ranking Minority Member Peterson, members of the House Agriculture Committee, my name is Floyd Gaibler. I am the Director of Trade Policy & Biotechnology for the U.S. Grains Council. The Council is a private, non-profit organization representing U.S. producers of corn, sorghum, barley and co-products such as ethanol, distiller's dried grains with solubles (DDGS), and corn gluten feed and meal, and as well as associated agribusinesses.

Founded in 1960, the Council now has 10 international offices, representatives in an additional 15 locations and a network of consultants and partnerships that support programs in more than 50 countries. Our members, leadership and staff fundamentally believe exports are vital to global economic development and to U.S. agriculture's profitability.

On behalf of the Council, I appreciate the opportunity to appear before the Committee and provide our perspective on the economic implications with respect to the modernization of the North American Free Trade Agreement (NAFTA).

Importance of NAFTA to U.S. Grains and Ethanol Sectors

NAFTA has had a profound effect on many aspects of North American agriculture. **With a few exceptions, intraregional agricultural trade is now completely free of tariff and quota restrictions, and the agricultural sectors of NAFTA's member countries – Canada, Mexico and the United States – have become far more integrated, as is evidenced by rising trade in a wider range of agricultural products and substantial levels of cross-border investment.**

The U.S. feed grains industry has benefitted substantially from NAFTA. Rising demand for feed and food has created new opportunities for intraregional trade in grains and oilseeds. Poultry and hog producers in Mexico, for instance, rely heavily on imported feedstuffs to meet their country's growing demand for meat. Due to the proximity and natural logistics advantages, Mexican feed millers and livestock producers have expanded and gained significant efficiencies by utilizing a "just-in-time" inventory management system based on U.S. reliability of supply.

Mexico is the top market for U.S. corn while Canada ranks as the ninth largest customer. Mexico and Canada ranked as the top two markets for U.S. barley in marketing year 2015/2016. Mexico is the second largest market for U.S. sorghum. Mexico and Canada have become the second and seventh largest markets, respectively, for distiller's dried grains with solubles (DDGS). In the recent marketing year, Canada remained the top market for U.S. ethanol while Mexico was the eighth largest customer.

The United States exported more than 29.3 million metric tons of feed grains in all forms to Canada and Mexico in marketing year 2015/2016, valued at $9.9 billion. The feed grain in all forms variable accounts for feed grains exported by the United States in either unprocessed or value-added forms, which offers a holistic look at demand from global customers being met by U.S. farmers.

Preserve and Protect Market Access

In our communications with the Executive Branch, we exhorted that all efforts should be expended to maintaining all existing commitments in a "do no harm" manner and expanding upon current market access and other provisions that enhance U.S. market share in both the Canadian and Mexican markets, and that promote economic integration and support farm incomes**. In addition, it is imperative that other negotiating objectives or independent trade policy actions that could result in retaliation should be avoided at all costs**. Agriculture has traditionally been the first target in response to disruptions in trading relationships. The 2009 trucking dispute with Mexico and the threat of retaliatory duties on U.S. agricultural products as a result of U.S. Country of Origin Labeling provisions are prime examples of our vulnerability.

Moreover, the recent furor of the proposed executive order to withdraw from NAFTA has prompted the Mexican government to look to Brazil and Argentina for alternatives sources of corn and other grain products. We have strong but unconfirmed evidence that Mexico is slated to purchase between 7 and 8 cargoes of corn from South America beginning in August and September. Given the political uncertainty, our customers have told us that rather than continue to future positions for grain purchase, a strategy key to mitigating price risk to purchase corn and co-products, they will resort to the more volatile and risky spot market. **Those decisions have resulted in a 4% decline in corn exports (7 percent in terms of value) since the beginning of the year when compared to 2016. We expect further erosion if the shipments from South America materialize as we anticipate.**

Since March, our President and CEO Tom Sleight and Chairman Chip Councell have traveled twice to Mexico to meet with our customers and government officials. The Council also invited our top feed and livestock customers to the United States in May to meet with U.S. industry as well as members of the U.S. Congress and the U.S. Department of Agriculture. In addition, our board of directors traveled to Mexico in June to meet with our customers and government officials. We can tell you from firsthand knowledge in participating in the meetings both in Mexico and here at home, that the concerns and resultant impacts are real and tangible.

Economic Implications of NAFTA Negotiations

To more concretely understand both the risks of ending NAFTA, and the potential improvements from a successful modernization of NAFTA, the Council, along with the U.S. Soybean Export Council and U.S. Wheat Associates commissioned an econometric analysis led by World Perspectives, Inc. and the assistance of Perdue University.

With zero tariffs for U.S. feed grains and co-products under the current NAFTA agreement increased market access depends on facilitating trade and the reduction of non-tariff barriers. There is no good quantitative measure of the levels of non-tariff protections or trade costs that can be reduced via negotiating structures, but it is feasible to examine the impact of expanded market access at the margin. For example, it is possible to experiment with the impact of increasing intra-NAFTA market access by a 1% *ad valorem* tariff equivalent. In other words, take the negative economic impact of Canada and Mexico both imposing a 1% tariff on imports of U.S. feed grains and then assume the positive equivalent of that economic impact from improving the technical terms of trade (rules of origin, customs clearance, SPS, etc.).

The results demonstrate that the U.S. feed grain industry has the potential to realize gains from improved terms in a modernization of NAFTA, with Mexico a more significant contributor to those benefits than Canada. U.S. corn production increases in value by $80 million, but less than a quarter of that goes into direct export to Mexico and Canada. The majority of the increase in U.S. corn exports to Canada and Mexico is in the form of value-added products from livestock and other foods. So the increase in U.S. feed grain production it utilized under an improved NAFTA demonstrated there is the potential for gains from further reduced barriers to trade, and particularly for expanding U.S. feed grain and grain derived product exports to Mexico.

Conversely, if the negotiations fail and we quit NAFTA, it is unclear what specific future polices would be chosen. But one assumption is that all three North American countries would end all North American preferences. This potentially means that each country reverts to applying their respective most favored nation (MFN) duties. The MFN rates are the maximum tariffs that can be imposed based on World Trade Organization (WTO) obligations and they vary from country to country. Mexico's MFN duty rates range from 20-40%; versus 1-10% for the U.S. and Canada.

The results of the analysis finds that the negative price impact on U.S. corn (-$0.02/bushel) is relatively small since exports to Mexico are a very small share (0.0012% of total world utilization. U.S. corn production falls by an average of 150 million bushels annually, which equates to around $800 million dollars in value or about $6/acre. Total U.S. grain production falls by $1.2 billion.
While the changes in U.S. per profit margins appear modest, (2-3 percent), this is because the model assumes a partial offset from the shock in the near term by an annual average of $1.2 billion in farm program payments. More pronounced is the large macroeconomic impact with U.S. GDP falling by $13 billion.

Obviously, commodities are fungible and markets adjust over time. In addition, impacts extend to other farm product with interlocking relationships, such as livestock products. A drop in overall farm income can have spillover effects that could lead to changes in farm structure, the idling of land or its conversion to alternative uses—further lowering corn profitability.

Negotiation Objectives and Priorities

In our formal comments to the Administration, we advocated that this negotiation should build on and strengthen the objectives under the **Trans Pacific Partnership (TPP**) that was developed to represent a 21st century high level agreement that serves as a template for all future trade negotiating architectures. At the same time, there were positive elements under the **Trans-Atlantic Trade and Investment Partnership (T-TIP) as well as recent U.S. free trade agreements (e.g., Korea-U.S. FTA)** that should be considered when developing U.S. negotiating objectives. The Council is a member of the U.S. Food and Ag Dialogue for Trade and our supportive of their views with respect to negotiating objectives.

National Treatment and Market Access for Goods

The Council urged the Administration for the **continued elimination of all tariff preferences and/or quotas for corn, corn-coproducts (corn gluten feed, corn gluten meal, grain sorghum, barley and malt; ethanol and dried distiller grains).**

TPP also provided important provisions that addressed major policy issues and merit inclusion in a modernized NAFTA agreement including: **Export Subsidies; Export Guarantees or Insurance Programs; Agricultural Export State Trading Enterprises; Export Restrictions—Food Security; and Agricultural Safeguards.**

Sanitary and Phytosanitary (SPS) Measures

The NAFTA agreement included provisions to establish a framework of rules and disciplines to guide the development, adoption and enforcement of sanitary and phytosanitary measures. While perhaps suitable at that time, subsequent free trade agreements have made significant improvements over the foundational SPS language of NAFTA.

Protectionist sanitary and phytosanitary measures that lack a scientific basis and are not based on a risk assessment continue to unjustifiably restrict access for U.S. food and agricultural exports in numerous foreign markets. While the WTO Sanitary and Phytosanitary Agreement established important science-based principles to challenge such restrictions, enhanced provisions are needed to ensure that SPS issues are resolved in a timely manner and do not result in significant unnecessary delays to our sector's perishable exports.

TPP provided a strong **Sanitary and PhytoSanitary (SPS) Chapter** that builds on the WTO's 1994 SPS agreement rather than simply reaffirming commitments to the WTO SPS agreement. We would support improving these provisions, in particular the following areas: Equivalence; Science and Risk Analysis; Import Checks; Transparency: Cooperative Technical Consultations; and when the CTC mechanism does not resolve a matter, parties may use provision's dispute settlement mechanism to enforce most of the SPS commitments. In particular the creation of a rapid response mechanism, including tighter standards and deadlines for adverse import checks will be critical in addressing future SPS issues.

Biotechnology

While products derived from agricultural biotechnology are grown in 28 countries and are traded widely, there remains a lack of synchronicity between countries, particularly countries that approve these products and countries who import them. This unpredictable regulatory and trade environment has resulted in trade disruptions that have caused economic impacts and delayed opportunities for farmers to have access to new technologies.

The North American Free Trade Agreement (NAFTA) came into force two years prior to the commercialization of the first biotech crops in 1996. Since that time, biotech acreage across multiple crops has grown rapidly because of the increased productivity and, environmental benefits associated with this technology.

Since the NAFTA entered into force, the global regulatory framework for biotech crops has expanded, sometimes resulting in redundant measures, leading to an unpredictable, and time-consuming global regulatory environment, which in turn has imposed high barriers to efficient trade. Corn and soybean products often are evaluated for their safety by 20 or more governments, all generally following the same standards for assessment and evaluating the same data. The timing of approval of these products affects the entire crop value chain. If a product is commercialized in one plant crop in the absence of globally synchronized regulatory approvals, trade disruption may occur in multiple crops and processed products used for food, feed and further processing, even though the product has completed a risk assessment and been approved in one or more countries. Similarly, asynchronous approvals have contributed to the delayed introduction of new technologies for use by agricultural producers, resulting in lost opportunities for farmers and product developers, as well as other participants in the value-chain, to capitalize on the introduction of new biotech traits.

Under a modernized NAFTA, the Council advocated efforts that the U.S. government: **(1) enter a mutual recognition agreement with Canada and Mexico on the safety determination of biotech crops intended for food, feed and for further processing, and (2) develop a consistent approach to managing low-level presence (LLP) of products that have undergone a complete safety assessment and are approved for use in a third country (ies) but not yet approved by a NAFTA member.** The Council is also a member of the U.S. Biotech Crops Alliance and supports their position on this issue.

Coherent National Renewable Fuel Standards

Since NAFTA went into effect in 1994, the U.S. ethanol industry has grown dramatically, expanding production more than eleven-fold from a modest 1.2 billion gallons in 1994. Today, the U.S. is now the most reliable and affordable source for clean-burning, high-octane ethanol in the world. Our industry supports more than 340,000 jobs and promotes the growth of rural America and the farm economy through the use of more than 5 billion bushels of U.S. corn to make ethanol and associated coproducts. In 2016, our industry produced more than 15 billion gallons of ethanol and 47 million metric tons of distiller's grains, contributing more than $30 billion to our nation's economy. In addition, we exported over 1.2 billion gallons of ethanol at a value of more than $2 billion and 11.3 million metric tons of DDGS.

Today, Canada and Mexico are two of the U.S. ethanol industry's strongest trading partners, with Canada emerging as the destination for more than 25 percent of all U.S. ethanol exports, and Mexico recently emerging as the top destination for U.S. DDGS exports. Our industry's successful entry and trade into the Canadian and Mexican markets are a direct result of NAFTA's elimination of tariffs on goods such as ethanol and distillers grains.

NAFTA modernization provides an excellent opportunity to **recognize and support modernized energy policy**, we recommended to the Administration that they **maintain the current policy of zero tariffs** on ethanol amongst the three countries. We would also encouraged them to work to **prevent the introduction of any potential technical barriers to trade.** Currently, while the transportation fuel markets and ethanol blend dynamics differ in Canada, Mexico, and even within the U.S., there appear to be few, if any, true barriers to trade. We would not want any such barriers to be introduced in the future, as we would like to keep these fuel markets as open and as workable as possible for our U.S. producers.

Conclusion

In conclusion, the U.S. grains sector has significantly benefited from more liberalized trade in the past 30 years, and the Council believes expanding access to export markets will continue to drive the success of American agriculture for years to come.

In no case has this been more apparent than in our trade relationship with Canada and Mexico. **NAFTA has provided the trade underpinnings that has resulted in the most efficient and effective interregional grain and livestock value chain in the world.**

But to take advantage of this and other emerging export opportunities – and to maintain our competitiveness in the global marketplace - trade liberalization must continue at all levels, bilateral, regional and multilateral. **Trade agreements hold the key to opening markets and resolving tariff and non-tariff barriers to allow the movement of coarse grains, co-products in all forms and other agricultural exports to where they are demanded. With effective policies in place and followed, trade works – and the world wins.**