

**THE U.S.-MEXICO FREE TRADE AGREEMENT:
ISSUES AND IMPLICATIONS FOR THE U.S. AND
TEXAS GRAINS AND FEEDS INDUSTRY**

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Texas Agricultural Market Research Center (TAMRC) U.S.-Mexico Free Trade Issues for Agriculture Series, TAMRC International Market Research Report No. IM-4-91, by Dr. Mark L. Waller, Dr. Gary W. Williams, and Mr. DuBoise White, Texas Agricultural Market Research Center, Department of Agricultural Economics, Texas A&M University, April 1991.

ABSTRACT: This report considers the issues relating to a U.S.-Mexico FTA relevant to the U.S. grain and feed industries. The report provides some historical background information on the production and consumption of coarse grains and wheat in Mexico and the trade of these commodities with Texas and other regions of the U.S. The implications and potential impacts of U.S.-Mexico FTA on the U.S. grain and feeds industry are outlined. Priority issues of particular importance to the U.S. grains and feed industry are identified and discussed.

The Texas Agricultural Market Research Center (TAMRC) has been providing timely, unique, and professional research on a wide range of issues relating to agricultural markets and commodities of importance to Texas and the nation for more than two decades. TAMRC is a market research service of the Texas Agricultural Experiment Station and the Texas Agricultural Extension Service. The main TAMRC objective is to conduct research leading to expanded and more efficient markets for Texas and U.S. agricultural products. Major TAMRC research divisions include International Market Research, Consumer and Product Market Research, Commodity Market Research, and Contemporary Market Issues Research.

U.S.-MEXICO FREE TRADE AGREEMENT: ISSUES AND IMPLICATIONS FOR THE U.S. AND TEXAS GRAINS AND FEEDS INDUSTRY

EXECUTIVE SUMMARY

The proposed free trade agreement (FTA) between the U.S. and Mexico seeks to expand the level of trade between the two countries through the reduction or elimination of tariffs and nontariff barriers. This paper examines issues and implications of this proposal for the U.S. and Texas coarse grain and wheat markets. The essential points of this paper include the following:

- During the early 1960s, Mexico was a net exporter of coarse grains and wheat. Improvements in yields and acreage expansion were more than able to offset growing demand. However, as acreage expansion began to reach its limits in the 1970s and other resources such as water, became limiting factors, demand exceeded production, resulting in Mexico becoming a net importer of coarse grains and wheat throughout most of the 1970s and 1980s.
- Although Mexican coarse grain and wheat imports are highly erratic and determined largely by the unpredictable effects of weather and domestic production, Mexico has become an increasingly larger importer of coarse grains and wheat. The majority of these grain imports have come from the U.S. but have been subjected to tariffs, import licenses, and other trade restrictions.
- Both Mexico and the U.S. have extensive commodity support policies that include price supports, input subsidies, and other elements that could distort free trade.
- Mexico is currently a major importer of U.S. coarse grains and wheat. Mexican farm level prices are also normally supported at levels above prices for those commodities in the U.S. A reduction of trade barriers would likely increase Mexican imports of U.S. coarse grains and wheat.
- Given the relative sizes of the grain industries in the U.S. and Mexico and the current excess capacity existing in U.S. agriculture, it is unlikely that the increase in U.S. exports to Mexico would substantially change prices in the U.S. Prices for these commodities in Mexico, however, if allowed to adjust to market forces could fall substantially from their present levels. This could also result in the dislocation of a large portion of the Mexican population currently involved in agriculture.
- Grain and feed issues for the U.S.-Mexico FTA negotiations include existing tariff and nontariff barriers in grains, the dynamics of the adjustment process to freer trade between the two countries, domestic commodity policies in both countries, an inadequate Mexican transportation and infrastructure, Mexican internal restrictions to competitive trade, third country access, and agricultural labor issues.

U.S.-MEXICO FREE TRADE AGREEMENT: ISSUES AND IMPLICATIONS FOR THE U.S. AND TEXAS GRAINS AND FEEDS INDUSTRY

The U.S. and Mexico have taken the first steps in negotiating a free trade agreement (FTA). The Presidents of both countries issued a joint statement on the negotiation of a bilateral free trade agreement in June of 1990. In August of that same year, the Mexican government sent a formal request to the United States to enter into negotiations. In September, the Bush Administration notified Congress of its intent to negotiate a free trade agreement with Mexico. Congress is currently considering re-authorization of the "fast track" negotiating authority set to expire at the end of May 1991.

The economic impact of a U.S.-Mexico FTA will ultimately depend on what the final agreement looks like and the transition rules it contains (USDA, 1991). In general an FTA would be expected to result in greater prosperity for both countries. Increasing growth and competitiveness in both economies would translate into more jobs, products that are more globally competitive, and increased exports for both countries. Coupled with the Canadian FTA, the U.S. would find itself in the middle of a North American FTA with a combined output 25% larger than that of the European Community (EC)

Although initial rhetoric suggested that everything would be on the table, both sides have suggested that labor would not be included in the negotiations. Mexico has also been waffling on including corn, wheat, rice, and dry bean production industries (*ProFarmer*).

This report considers the major issues relating to a U.S.-Mexico FTA relevant to the U.S. grain and feed industries. After providing some historical background information on the production and consumption of coarse grains and wheat in Mexico and the trade of these commodities with Texas and other regions of the U.S., the likely implications and potential impacts of a U.S.-Mexico FTA on the U.S. and Texas grain and feed industry are outlined. The information provided should help provide focus to the debate on free trade with Mexico and will be used in ongoing research to quantify magnitudes of potential impacts of a U.S.-Mexico FTA. Finally, priority issues of importance to the U.S. coarse grains and wheat industry are identified and discussed.

BACKGROUND

The likely impacts and issues for coarse grains and feeds relating to a U.S.-Mexico FTA must be considered in the context of the current market situation in Mexico and current trade linkages between the two countries. Consequently, this section provides an overview of the Mexican coarse grain and feed situation and outlines U.S.-Mexico grain and feed trade flows and related trade issues.

Mexican Coarse Grain and Feed Market Situation

Several dimensions of the Mexican market for grains and feeds are discussed in this section, including the current supply and demand situation in Mexico, Mexican foreign trade, and Mexican agricultural policy relating to grains and feed.

Mexican Coarse Grain and Feed Supply and Demand Situation

The balance between supply and demand for coarse grains and wheat in Mexico has shifted dramatically over the last 30 years with the vast majority of the variability being accounted for by major changes in production. Most of the production variability can be accounted for by the influences of climate and changing government policy, much the same factors that influence U.S. production variability. Mexican agriculture, however, given its geographic location, has been more susceptible to climatic variability. Given its political history, Mexico has also been more susceptible to unpredictable major policy changes. Demand for coarse grains and wheat, on the other hand, grew at a strong steady pace throughout the 1960s and 1970s as population continued to expand and per capita incomes increased from 1960 to 1979. The 1980s, however, experienced the ravages of the debt crisis. As a result, the demand for both coarse grains and wheat trended lower for the first time in 30 years. Mexico has since undertaken a number of major economic reforms based on more open markets in an attempt to reduce inflation, lower the debt, increase foreign investment, and re-stimulate the economy (Polyconomics). If this effort is successful, real income levels should begin to improve considerably and demand should begin to grow again.

Coarse Grains

Coarse grain production grew well in the early to mid-1960s as acreage expanded and technological improvements allowed for significant yield increases (see Appendix). During much of this period, production of both corn (used largely for food rather than feed in Mexico) and other coarse grains was greater than consumption, allowing Mexico to be a net exporter of coarse grains during much of the period. During the 1970s, however, acreage expansion and yield increases both slowed as the limits were approached on new available land. Coarse grain production, as a whole, came more in line with consumption. Corn production, however, has consistently fallen below demand since 1973 forcing Mexico to rely more and more heavily on imports to meet the steadily growing consumption needs of its expanding population throughout the 1960s and 1970s.

The culmination of the debt crisis in the early 1980s resulted in major changes in the trending patterns of production, consumption, and consequently trade during the rest of the decade. While the farm level price and guarantee prices rose in terms of pesos/metric ton (mt) from 1981 to 1982, the drop in the real value of the peso resulted in producers realizing a 25% to 35% drop in the price of their products in U.S. dollar terms (Tables 1 through 3). As a result, area harvested and production dropped dramatically for corn and other coarse grains. The eroding value of the peso and higher consumer prices resulted in a significant drop in consumption as well. This drop in demand, however, was far less severe than the drop in production and resulted in record levels of imports of corn and other coarse grains to meet demand. Since the early 1980s, both production and consumption seem to have resumed an upward trend. Production, however, has consistently fallen short of consumption, forcing Mexico to continue to rely heavily on imports to make up for production shortfalls.

Wheat

Wheat production outpaced consumption in Mexico during the 1960s based largely on increasing yields (see Appendix). However, by the early 1970s, the decreasing harvested acreage allowed consumption to catch up with and exceed production. Consumption continued to grow at a faster and more consistent rate than production throughout the 1970s, resulting in an increasing trend in wheat imports during the decade, the vast majority of which came from the U.S. (Table 5). During the early 1980s, imports trended lower as production and consumption came more in line. By the mid

to late 1980s, however, both production and consumption began to trend lower with production dropping more rapidly and imports again beginning to trend higher.

While wheat production has been able to satisfy or exceed demand during brief periods over the last 30 years, the rapidly growing population and improving real wage rates of Mexico may no longer allow the country to attempt to attain self-sufficiency in wheat production as has been a long-term goal. Instead, Mexico may be forced to supplement its growing wheat needs with increasingly larger imports from outside its borders.

Mexican Foreign Trade of Coarse Grains and Feeds

Although Mexico was a net exporter of coarse grains and wheat during the 1960s, consumption began to outpace production of wheat, corn and other coarse grains in the 1970s (see Appendix). As a result, Mexico, though still interested in obtaining self-sufficiency in food production, was forced to import coarse grains and wheat to satisfy the needs of its growing population. While imports trended higher into the late 1970s for both coarse grains and wheat, the levels of imports were erratic and highly dependent on weather variability and changes in government policies.

The culmination of the debt crisis in the early 1980s led to a spike up and then a sharp drop in imports both from the U.S. and the rest of the world. However, the drop in imports was relatively short-lived and began an upward trend again during the late 1980s. Mexican coarse grain imports from the U.S. as a percentage of total Mexican coarse grain imports have varied from 43% in 1972 to nearly 100% in other years. Mexican wheat imports from the U.S. as a percentage of total wheat imports have varied from 0% to 100% of their total imports of wheat. By virtue of their close proximity and on the basis of transportation costs alone, the U.S. has been able to capture a large portion of the Mexican import business in wheat and coarse grain, as well as other major agricultural commodities.

Given the tight supply of agricultural land and water resources in Mexico, it is likely that a U.S.-Mexico FTA would induce continued expansion of Mexican coarse grain and wheat imports from the U.S. well into the 1990s assuming continued population and economic growth.

Mexican Coarse Grain and Wheat Policy

Although the Mexican government is currently emphasizing trade liberalization and the deregulation of domestic markets in most areas, past Mexican economic policies were heavily slanted toward self-sufficiency and food security (Polyconomics). As a result of those policies, Mexican coarse grain and wheat production, consumption, and trade have been strongly influenced by a wide array of government programs, policies, and institutions. The Mexican goal of food self-sufficiency for food security reasons is still very much in place for food corn, dry beans, and other agricultural commodities. These policies will likely provide a major stumbling block in trade negotiations. Mexican farm incomes have been supported by minimum guaranteed price policies, government controlled and subsidized input prices, and subsidized marketing costs. Consumption has also been subsidized and enhanced by providing retail price subsidies.

Since the 1950s, the government has used a guaranteed minimum price policy to support farm prices. Through the *Compañía Nacional de Subsistencia Popular* (CONASUPO), the Mexican government guarantees the purchase of domestic production at fixed minimum prices. These prices were announced annually prior to 1981 after which the official policy has been to make two

announcements, one before planting and another at harvest time to adjust for inflation. In July 1989, Mexico changed from a guaranteed price to an agreement price for wheat, rice, barley, and sorghum. The government guaranteed prices were kept in place for corn and dry beans.

The agreement price is the result of a consensus between Mexican farm organizations and food processors arrived at in meetings presided over by representatives from CONASUPO and the Mexican Secretaries of Agriculture and Commerce. Unlike the guaranteed prices, the agreement prices are announced just prior to or during harvest so that producers have no information on prices prior to planting.

To encourage the use of modern inputs and technological advances, input prices have been subsidized in general, with higher subsidies going to lower income producers. Some of these inputs include interest on farm credit, irrigation, improved seed varieties, chemical fertilizers, and crop insurance. Producers have also received indirect subsidies on public sector goods that are sold at subsidized prices such as gas, electricity, and transportation.

If a U.S.-Mexico FTA requires a reduction in the level of these subsidies, however, farm production input costs would likely rise significantly. This would likely lead to a leveling off or reduction in the use of many of these inputs and, consequently, a reduction in the rate of crop yield/hectare improvements seen over much of the last 30 years.

The U.S.-Mexico Trade Linkage in Grains and Feeds

Unlike fruits and vegetables and livestock, U.S. trade with Mexico in grains and feeds has been overwhelmingly a one-way process from the U.S. to Mexico. This section examines the U.S.-Mexico trade picture for grains and feed and trade policies imposed by both Mexico and the U.S. affecting the flow of grains and feed from the U.S. to Mexico.

U.S. Exports of Grains and Feed to Mexico

Mexico is the third largest overall trading partner of the U.S. behind Japan and Canada. Since the early 1970s when Mexico began importing more coarse grains and wheat to satisfy its growing demand, it has become an increasingly important market for U.S. exports of feedgrains and wheat (see Appendix). Mexico was the sixth largest export market for total U.S. agricultural exports with 5.5% of the total in 1987-89. During that same period, Mexico ranked number three behind only Japan and Russia as a market for U.S. feedgrain exports with a 7.55% market share, or approximately 2-3% of total U.S. feedgrain production (USDA, 1990).

The potential for strong U.S. export growth to Mexico is of particular interest to the U.S. grain and feed industry because the U.S. has been losing export market shares for wheat and feedgrains in other foreign markets. With about 15% of its productive crop land currently withdrawn from use under government programs, increased foreign demand for U.S. grains and feed would allow more efficient use of U.S. agricultural resources. Although Mexico was not one of the ten largest world wheat importers in 1987-89, there have been years when Mexican wheat imports were substantial.

U.S. and Mexican Trade Policy

Although Mexico is still the second largest debtor nation in Latin America, the U.S. Department of Agriculture (USDA) provides major assistance to U.S. exporters seeking to do business in Mexico by providing credit guarantees on exports of U.S. commodities into Mexico. The USDA allocated over \$1.5 billion to underwrite private bank credits extended to Mexican exports of U.S. food and farm products in 1990. The largest beneficiaries of these credit benefits are corn, other coarse grains, oilseeds, and wheat (Richey and Raich). Although the USDA is not acting as a credit agency (i.e., extending credit), it does provide credit guarantees which act as an interest rate subsidy. This is because the lower level of risk of loan default allows a lower interest rate to be charged.

Because Mexican support prices for coarse grains and wheat have tended to be at levels higher than world prices, Mexico has used a combination of import permits and licenses, tariffs, animal and plant health regulations, and other nontariff barriers to restrict imports and protect the integrity of their price support programs. Because Mexico has encouraged "buy national first" policies, import licenses have not generally been issued until the domestic Mexican crop has been purchased.

Since the early 1980s, Mexico has been liberalizing its trade regime and has accelerated that process during the late 1980s. After joining the GATT talks in 1986, Mexico took major steps to reduce trade barriers and, in fact, went beyond the GATT requirements. The maximum tariff in November of 1986 was 100% and the average was 22.7%. By December 1987, however, the maximum tariff was down to 20% and the average was about half the 1986 average (Meilke).

For most grain imports, Mexico requires either import permits or tariffs, or both in some cases. Durum Wheat has a 10% tariff and also requires an import permit. Malting and feed barley also require an import permit and have a 5% tariff. Corn and milling quality wheat both require the use of an import permit, but neither has a tariff. Oat imports do not require a permit but are charged a 10% tariff. Grain sorghum imports no longer require an import permit nor are they charged a tariff (Davis).

Mexico has expressed more and more concern in recent years regarding grain quality. Mexican claims of higher than desired levels of broken kernels, foreign material, and the generally dirty condition of U.S. grain has led to an increasing level of trade disputes. Aflatoxin contamination of corn and grain sorghum shipments from the U.S. has become a major Mexican concern. Mexico now requires that all imported corn and grain sorghum must have USDA Federal Grain Inspection Service (FGIS) Certification that aflatoxin levels are 20 parts/billion or less.

Mexico has made efforts in recent years to diversify its sources of grain imports, spreading its import purchases among a number of major exporters including Canada, Argentina, the E.C., and Australia, rather than relying so heavily on U.S. markets. The need for credit assistance has hampered the diversification efforts to some extent by limiting potential suppliers. Although Canada, Argentina, and the E.C. have programs in place to provide credit assistance, the large GSM-102 allocations made by the USDA help insure a continued strong Mexican reliance on U.S. grains to meet import needs.

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Table 1. Mexico, U.S. and Texas Corn Farm Price.

Corn					
MEXICO			US	TEXAS	
Year	Pesos/\$	Pesos/MT	----- \$/Bu -----		
1960	12.5	729	1.48	1.00	1.14
1961	12.5	749	1.52	1.10	1.16
1962	12.5	762	1.55	1.12	1.17
1963	12.5	942	1.91	1.11	1.28
1964	12.5	945	1.92	1.17	1.26
1965	12.5	959	1.95	1.16	1.27
1966	12.5	918	1.87	1.24	1.43
1967	12.5	940	1.91	1.03	1.32
1968	12.5	934	1.90	1.08	1.15
1969	12.5	894	1.82	1.16	1.29
1970	12.5	905	1.84	1.33	1.42
1971	12.5	900	1.83	1.08	1.34
1972	12.5	902	1.83	1.57	1.53
1973	12.5	1,109	2.25	2.55	2.57
1974	12.5	1,463	2.97	3.02	3.09
1975	12.5	1,863	3.79	2.54	2.66
1976	15.4	2,167	3.57	2.15	2.33
1977	22.6	2,837	3.19	2.02	2.16
1978	22.8	2,912	3.25	2.25	2.45
1979	22.8	3,530	3.93	2.52	2.82
1980	23.0	5,019	5.56	3.11	3.44
1981	24.5	6,602	6.84	2.50	2.88
1982	56.4	9,766	4.40	2.68	3.09
1983	120.1	20,252	4.28	3.21	3.39
1984	167.8	34,950	5.29	2.63	3.03
1985	256.9	52,587	5.20	2.23	2.55
1986	611.8	91,050	3.78	1.50	1.87
1987	1,378.2	240,005	4.42	1.94	2.17
1988	2,273.1	690,000	7.71	2.54	2.70
1989	2,461.5			2.33	

SOURCE: Mexico Producer Prices for Agricultural Products 1960-1988, correspondence, Krawewski, Ricardo, USDA/ERS, received March 1990.
 Consumos Aparentes de Productos agricolas 1925-1982. Econotecnia Agricola, SARH, Sept., 1983.
 Agricultural Statistics. USDA, various issues.
 Agricultural Prices. USDA, various issues.
 Cash Receipts, Prices Received and Paid by Farmers. Tx. Dept. of Ag.

Table 2. Mexico, U.S. and Texas Wheat Farm Price.

Wheat				
		MEXICO	US	TEXAS
Year	Pesos/MT	----- \$/Bu -----		
1960	868	1.89	1.76	1.70
1961	912	1.99	1.74	1.80
1962	893	1.94	1.83	2.08
1963	915	1.99	2.04	1.91
1964	936	2.04	1.85	1.53
1965	944	2.06	1.37	1.34
1966	882	1.92	1.35	1.66
1967	849	1.85	1.63	1.46
1968	857	1.87	1.39	1.26
1969	849	1.85	1.24	1.25
1970	842	1.83	1.25	1.30
1971	861	1.87	1.33	1.45
1972	852	1.86	1.76	1.56
1973	890	1.94	3.95	3.04
1974	1,344	2.93	4.09	3.87
1975	1,724	3.75	3.55	3.38
1976	1,739	3.07	2.73	3.04
1977	2,127	2.56	2.33	2.15
1978	2,605	3.11	2.97	2.93
1979	3,000	3.58	3.78	3.83
1980	3,653	4.33	3.91	3.71
1981	4,736	5.26	3.66	3.65
1982	6,899	3.33	3.55	3.68
1983	14,039	3.18	3.51	3.55
1984	25,203	4.09	3.39	3.39
1985	37,159	3.94	3.08	2.97
1986	62,129	2.76	2.42	2.32
1987	120,000	2.37	2.57	2.36
1988	356,000	4.26	3.72	3.40
1989			3.72	

SOURCE: Mexico Producer Prices for Agricultural Products 1960-1988, correspondence, Krawewski, Ricardo, USDA/ERS, received March 1990.

Consumos Aparentes de Productos agricolas 1925-1982. Econotecnica Agricola, SARH, Sept., 1983.

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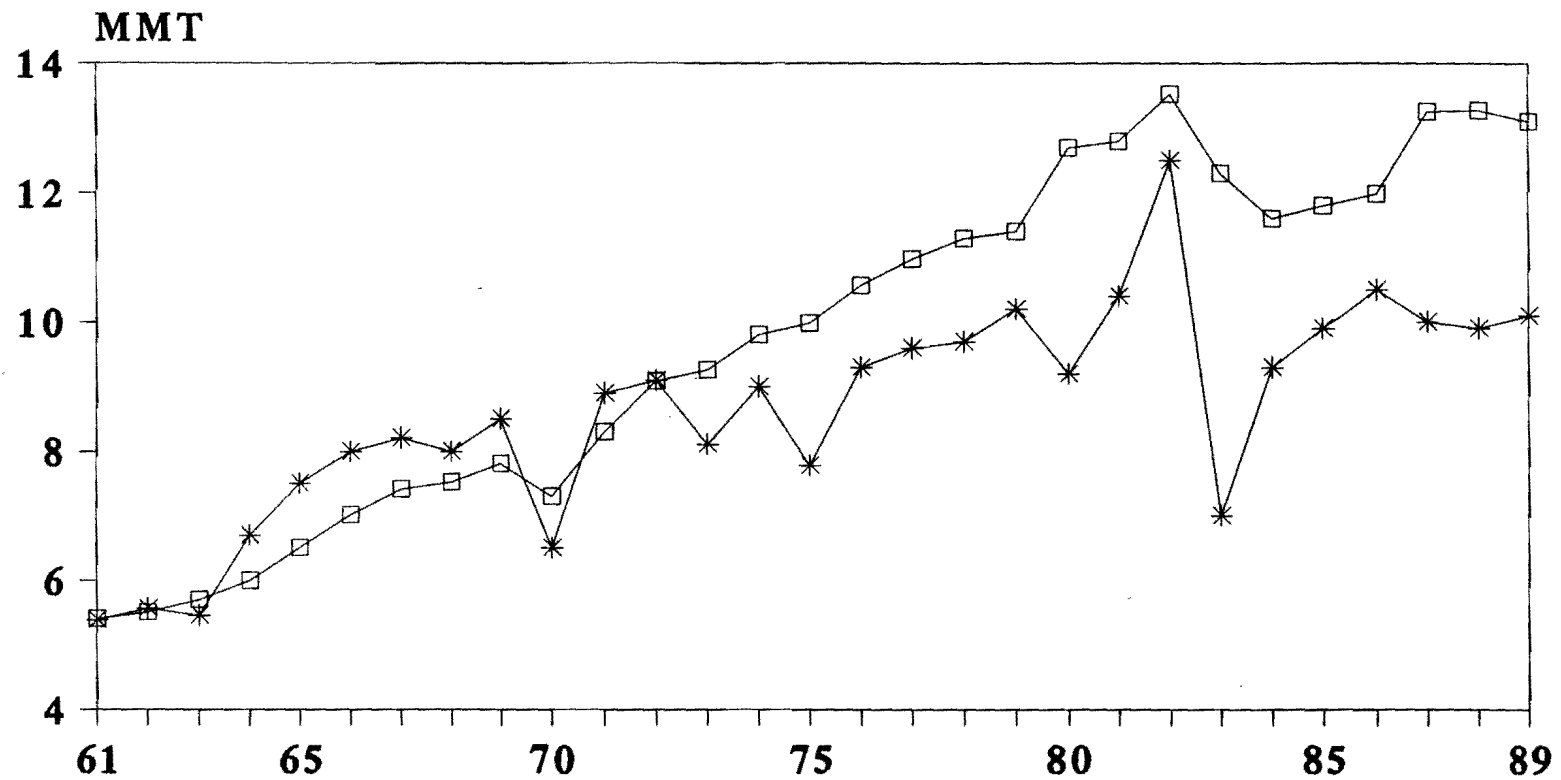
Cash Receipts, Prices Received and Paid by Farmers. Tx. Dept. of Ag.

Table 5. MEXICO WHEAT, 1960 - 1989 (1000s of Metric Tons) (Yield in MT).

Year	Area Harvest	Yield per He	Production	Beg. Stocks	Total Imports	Total Exports	Consumption	Ending Stocks	Imports from U.S.
1960	840	1.42	1190	150	7	0	1253	94	1
1961	837	1.68	1402	94	20	0	1305	211	20
1962	748	1.95	1455	211	36	0	1435	267	36
1963	819	2.08	1703	267	54	282	1469	273	49
1964	816	2.21	1800	273	31	406	1553	145	25
1965	847	2.47	2088	145	7	477	1600	163	1
1966	727	2.22	1612	163	1	30	1650	96	1
1967	751	2.74	2061	96	1	175	1750	233	0
1968	705	2.52	1780	233	1	0	1800	214	1
1969	783	2.45	1915	214	49	262	1850	66	3
1970	763	2.82	2148	66	5	40	2100	79	4
1971	697	2.90	2019	79	409	65	2342	100	402
1972	680	2.50	1700	100	650	16	2390	44	650
1973	720	2.78	2000	44	790	10	2729	95	705
1974	790	3.04	2400	95	832	19	2873	435	832
1975	802	3.62	2900	435	1	31	2990	315	1
1976	885	3.79	3350	315	1	40	3180	446	0
1977	775	2.97	2300	446	625	17	3155	199	580
1978	760	3.09	2350	199	1055	15	3400	189	921
1979	620	3.68	2280	189	1005	15	3400	59	981
1980	740	3.58	2650	59	1235	10	3500	434	1173
1981	850	3.59	3050	434	938	5	4000	417	747
1982	950	4.42	4200	417	50	10	4093	564	35
1983	840	3.81	3200	564	566	2	4100	228	0
1984	950	4.42	4200	228	491	5	4350	564	24
1985	1050	4.19	4400	564	92	6	4640	410	2
1986	1075	4.19	4500	410	463	3	5000	370	118
1987	900	4.11	3700	370	752	52	4300	470	296
1988	800	4.00	3200	470	1000	190	4095	385	
1989	950	4.11	3900	385	400	100	4250	335	

SOURCE: USDA, ERS.

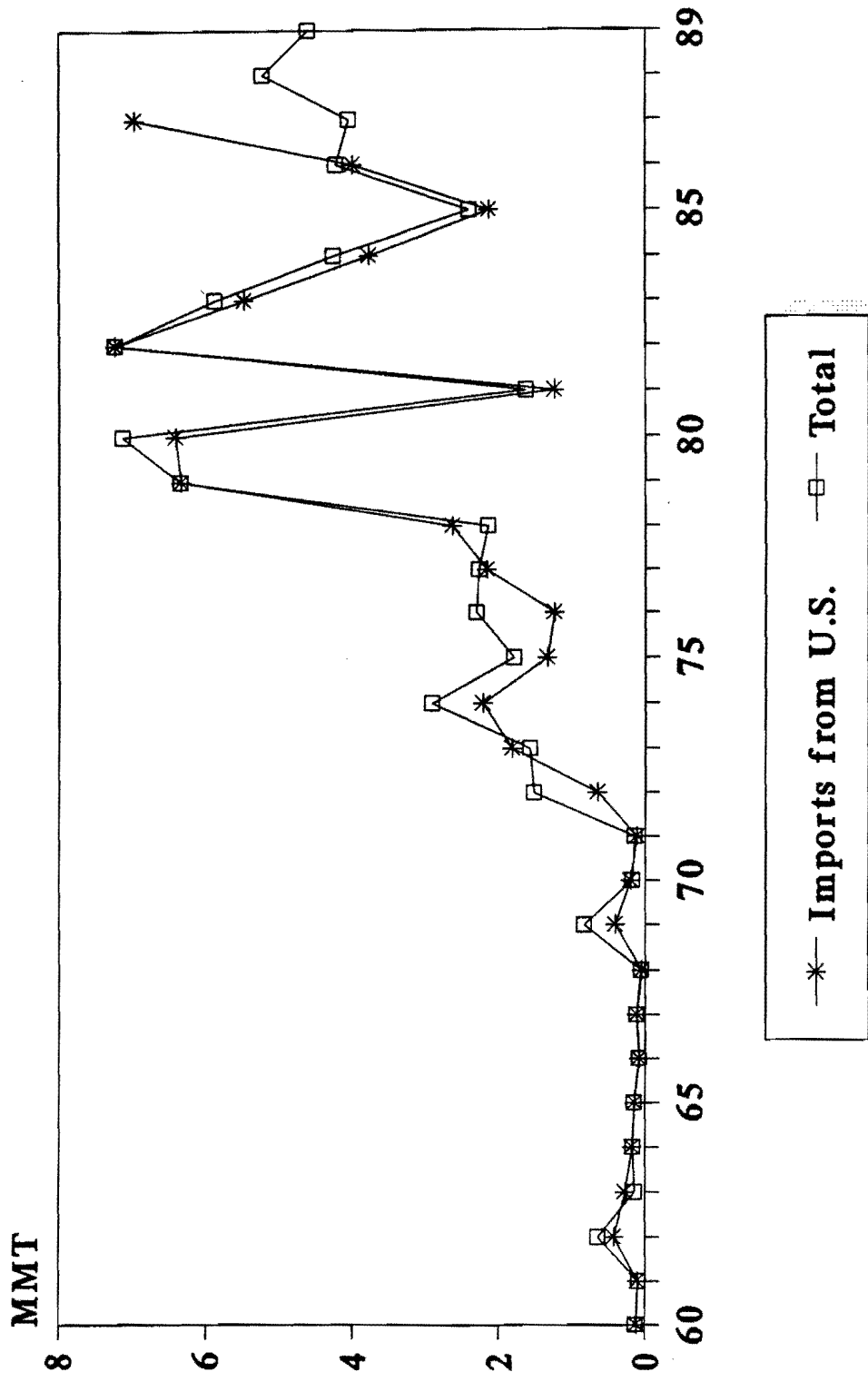
Mexico Corn Production and Consumption 1961 - 1989



* Production □ Consumption

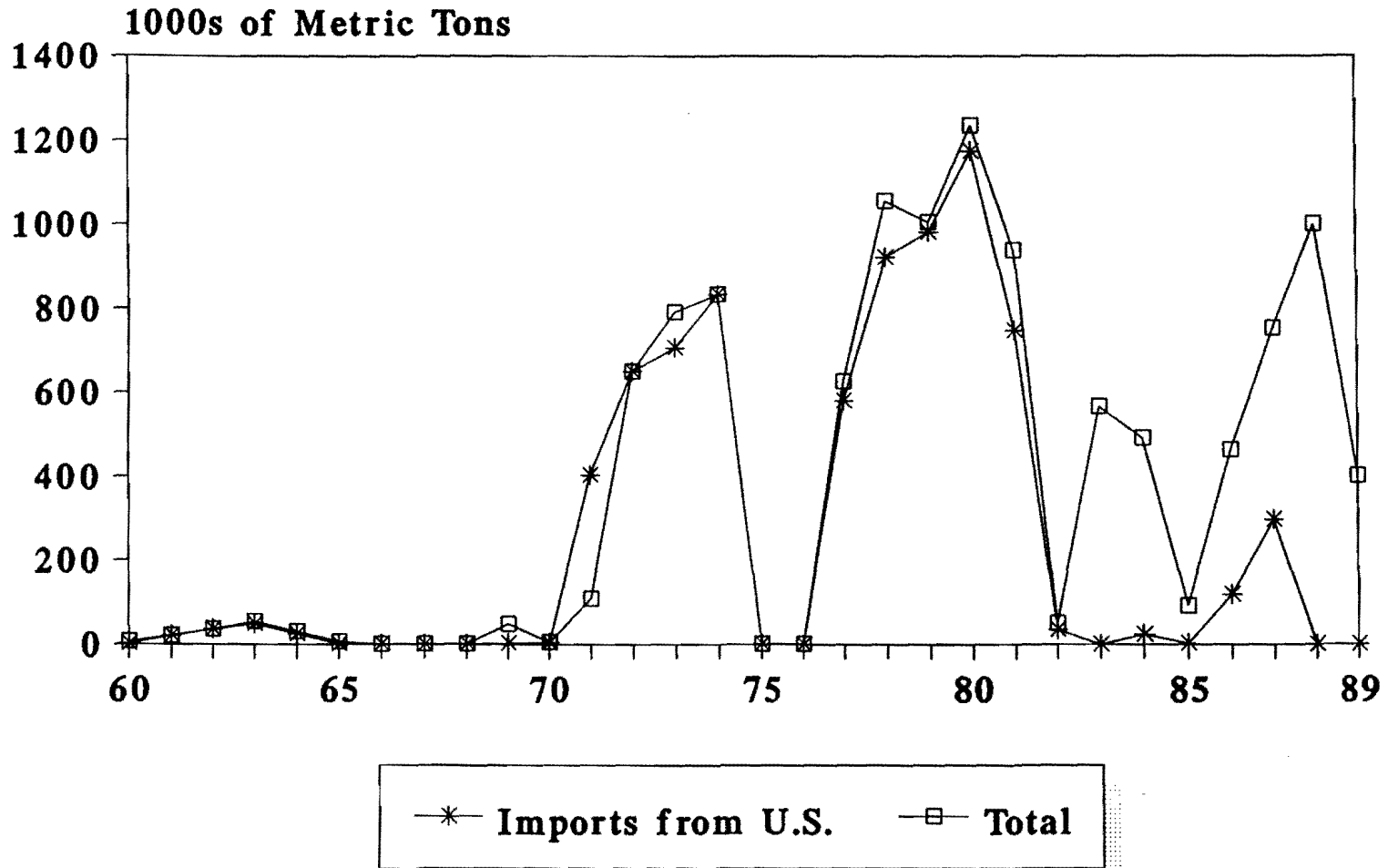
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Mexico Coarse Grain Imports from U.S. and Total, 1960 - 1989



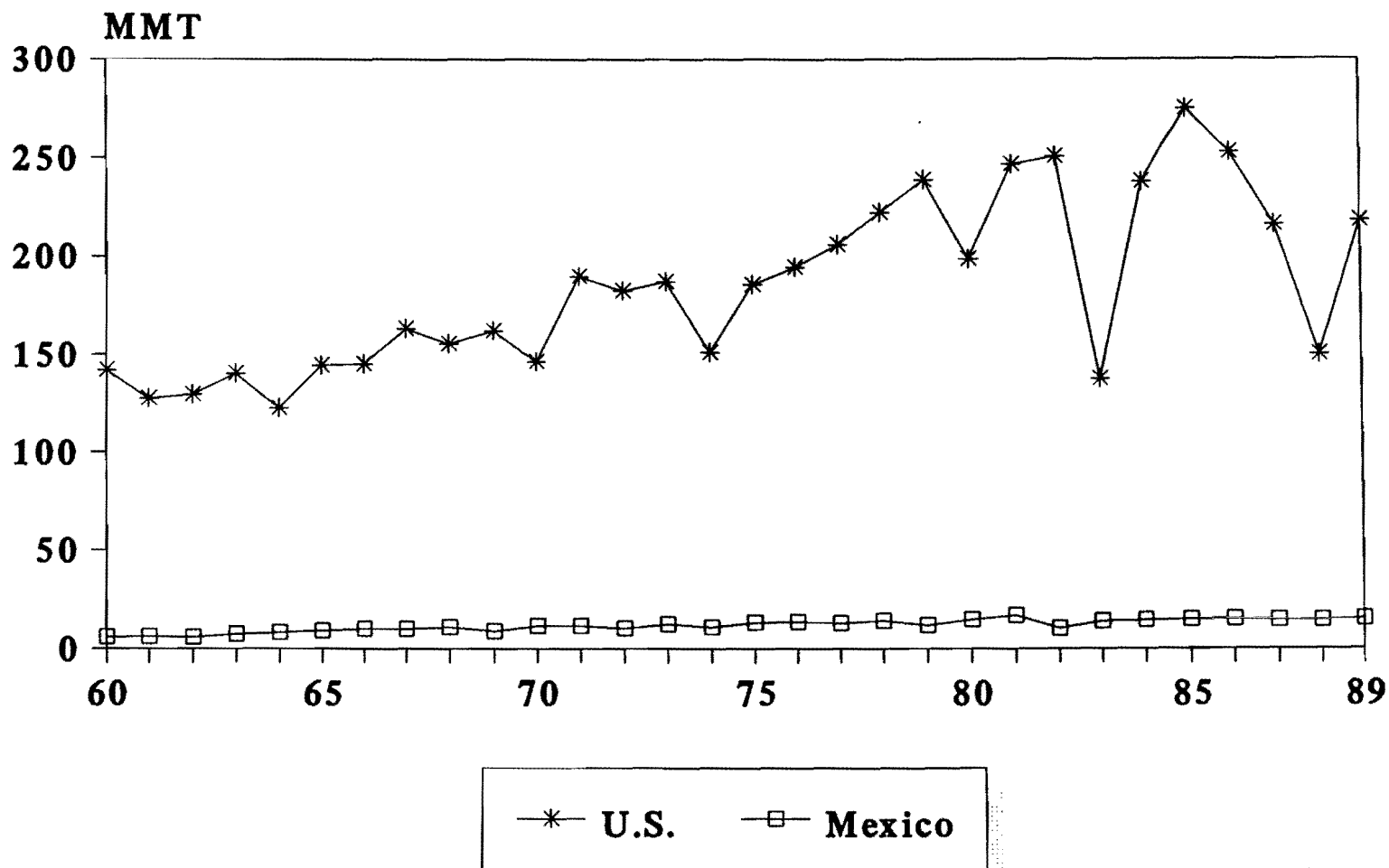
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Mexico Wheat Imports from U.S. and Total, 1960 - 1989



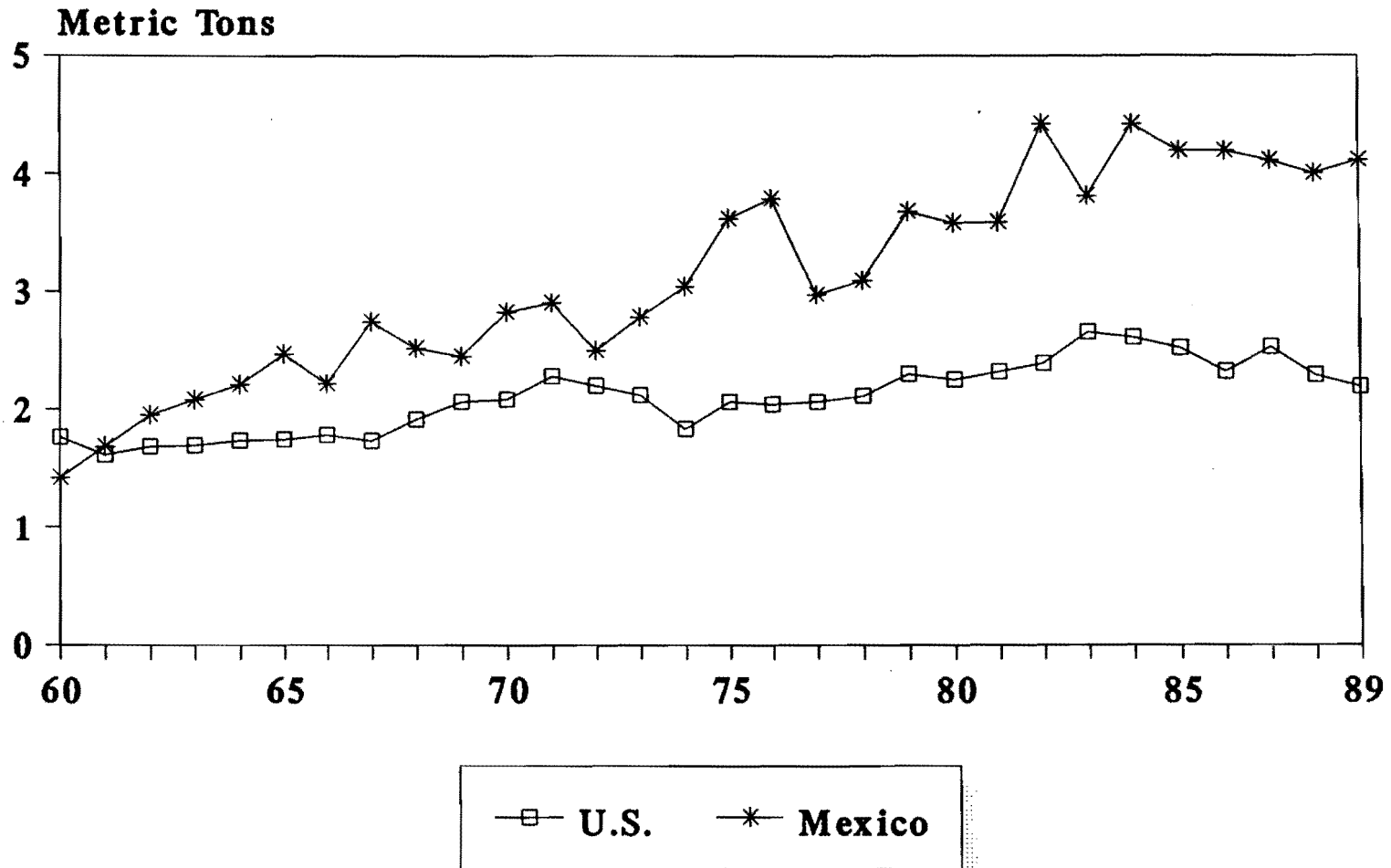
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U.S. and Mexico Coarse Grain Production 1960 - 1989



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U.S. and Mexico Wheat Yield Per Hectare, 1960 - 1989



usmxyld