Strategic Agricultural Trade Policy Interdependence and NAFTA:

Does the Exchange Rate Matter?

P. Lynn Kennedy

Abstract: *This paper seeks to determine the effect of the exchange rate on the willingness of the United States to participate in a trade agreement with Mexico and Canada. To accomplish this, we model various degrees of agricultural trade liberalization among these three countries using a partial equilibrium trade simulation model. The policy strategies of each country and their corresponding social welfare functions are employed in a game theoretic framework to determine the optimal strategy for each country given alternative levels of Mexican peso devaluation. This analysis shows that the United States moves away from free trade as the value of the peso decreases. These results demonstrate the sensitivity of U.S. agricultural trade liberalization to the value of the currency of its trading partners.*