The Canada-U.S. trade negotiations, initiated in September, 1985, are important to Canada's economy as a whole and to Canadian agriculture. Canada's desire to open up and guarantee access to the giant U.S. market is motivated by the opportunity to create a more efficient Canadian economy that can compete in world markets.

Trade is crucial to Canada and especially to Canadian agriculture. The importance of trade varies by commodity and this variation is the result of both comparative advantage and Canada's trade and domestic agricultural policies. Consequently, Canadian-U.S. trade relationships would be expected to vary by commodity as would solutions to conflicts in the cases in which they arise.

The Importance of Trade

The Canadian economy is highly integrated into the world economy. Canada exports more per person than any other developed nation (Table 1). In Canada, exports account for approximately 30 percent of the gross national product (GNP), contrasted with about 10 percent for the United States. Canada and the United States share the world's largest trading relationship. Ontario alone imports more from the United States than does Japan ($56.3 billion in 1985).

Table 1. Canada's Trade

<table>
<thead>
<tr>
<th>Total</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>U.S.</td>
<td></td>
</tr>
<tr>
<td>$120</td>
<td>$93</td>
<td>$112</td>
</tr>
<tr>
<td>77</td>
<td></td>
<td>69</td>
</tr>
</tbody>
</table>

Agriculture

Canadian agriculture is trade driven. Exports of farm and food products account for approximately one half of total farm cash receipts. Currently, the United States is Canada's largest and most diverse trading partner in farm and food products (Table 2).

<table>
<thead>
<tr>
<th></th>
<th>1985 (C$ bil.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exports</strong></td>
<td><strong>Imports</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>Total</strong></td>
</tr>
<tr>
<td>$8.9</td>
<td>$5.7</td>
</tr>
<tr>
<td>$2.4</td>
<td>$3.4</td>
</tr>
</tbody>
</table>

Source: Canada's Trade in Agricultural Products. 1985, Agriculture Canada

Trade Relationships

When Canada trades in international markets, it is essentially a price taker. Although Canada exports a substantial portion of its domestic production, these exports account for a small portion of world production. For example, Canada exports approximately 80 percent of its wheat production, but accounts for only 4.5 percent of the world's production. Thus, it can sell its wheat at the world price. In the trade literature, Canada would be referred to as a "small" country, one that doesn't affect the world price by trading more.

In contrast, when the United States trades in international markets it affects prices. The United States may export a smaller portion of its domestic production, but since this amount usually accounts for a much larger portion of world production, an increase in exports puts downward pressure on world prices. For example, the United States exports approximately 25 percent of its domestic feedgrain production and U.S. production accounts for about 30 percent of world production. Thus it is difficult for the United States to trade more or less feedgrains without affecting world prices. In the trade literature, the United States is a "large" country.

When the United States and Canada are "free" to trade with each other, U.S. actions have a larger effect on North American prices and trade flows than Canadian actions. We think of the pricing relationship in terms described by Figure 1.

Since the United States is a "large" country and Canada a "small" one, Canadian products are priced relative to U.S. products. The vertical axis measures prices for a standard unit (in Canadian currency). The horizontal axis measures quantities, produced, consumed and traded in a standardized unit. For products that can be traded, the Canadian price is above or below the U.S. price ($P_{us}$) by no more than transfer costs.
The segment $D_d$ represents Canada's domestic demand for a commodity. If the Canadian price differs from the U.S. price by less than transfer costs (the Canadian price, which is given by the kinked demand curve, minus the U.S. price), then Canadian product is priced on the domestic demand curve.

Figure 1: Canadian Pricing

The segment $D_i$ represents Canada's import ceiling. If the Canadian price exceeds the U.S. price by more than transfer costs, Canada will import from the United States. However, if Canada can buy more cheaply in world markets, it will import from countries other than the United States. For example, Canada and the United States both import bananas.

The last segment $D_e$ represents the export floor. If the Canadian price falls below the U.S. price by more than the cost of transfer, Canada will export to the United States. If Canada can obtain a higher price in world markets, it will export to countries other than the United States. This situation occurs for grains. Since both Canada and the United States are surplus in grains, both compete in world export markets and the average price in Canada may be above or below the U.S. price.

The "model" described with Figure 1 can be used to generalize about relative prices for major Canadian commodity groups. This is done in Figure 2. As we will see, most agricultural products fall into one of these three categories. The nature of price relationships for these three categories, in conjunction with Canada's status as a price...
taker, are two fundamental reasons for the variety of policy instruments we apply.

Since Canada is a small country, its agricultural policies have mainly been concerned with transferring income to producers and not removing resources from production. It would be the height of folly for Canada to act unilaterally in developing set aside programs and the like. Conversely, the status of the United States as a large country allows it to consider policies that remove resources from production. These types of programs, such as acreage diversion programs, have been the cornerstone of U.S. farm programs in recent decades.

Canada's natural competitiveness in certain products enables it to export. Not surprisingly, these commodities are the least protected. This group includes grains and the red meat complex commodities and accounts for nearly 60 percent of the gross farm output value. In terms of Figure 2, livestock are priced on the export floor. For livestock and red meats, the U.S. market is an important export destination. In 1985, approximately 90 percent of live animal exports and 70 percent of meat exports went to the United States. Since Canadian grain competes in world markets with that produced in the United States, the Canadian price may be above or below the U.S. price. Less than 10 percent of Canadian grain, oilseed and associated product exports go to the United States.

Figure 2: Pricing of Selected Agricultural Products
Canada's supply managed, or fully protected, commodities, dairy products and eggs and poultry, comprise approximately 20 percent of the gross value of Canada's farm output and are priced on the domestic demand curve. Prices are based on cost of production formulae, above the import ceiling, and on the domestic demand curve.

Another group of commodities can be considered as partially protected. Within this group there are several commodities that are priced on the import ceiling. This subgroup includes wines and grapes and fruits and vegetables.

**Canadian Agricultural Policies**

Canada's major policy instruments, as they apply to the least protected, partially protected and fully protected or supply managed sectors of the Canadian agricultural sector, are discussed below.

**Least Protected: Grains and Livestock**

Canada's livestock (red meats) sector is more market oriented than any other agricultural sector, but is the object of several public policies. Stabilization, marketing boards, public goods and the Meat Import Act constitute the major instruments used in this sector.

*Livestock Stabilization.* Stabilization policy for beef and pork is currently in a state of change. Until 1986, beef cattle and hogs were covered by the provisions of the Agricultural Stabilization Act (ASA) of 1975. This act obliged the federal government to make deficiency payments to producers in a year when the average market price is less than 90 percent of the previous five years, adjusted for changes in cash costs. The programs operated with several rule changes during their lives, but for the most part the amount of future price guarantee was not known in advance and any payments were made well after the end of the year. Due to dissatisfaction with the ASA, several provinces initiated their own stabilization programs to supplement the ASA. These programs vary in operation, but some trigger deficiency payments with cost of production formulas; others use historical price relationships. Most are partially financed by producers.

The Tripartite Red Meat Program was developed in order to deal with problems associated with these provincial “top-loading” programs and to insure that the intent of the ASA is met, i.e., that market signals get through to producers. The Tripartite Program is based on a margin guarantee rather than a price or income guarantee. It covers production up to the level of domestic consumption only. The federal and provincial governments and producers share in funding. It is voluntary on behalf of producers. The program is tailored to five individual commodities. Slaughter cattle, backgrounders and hogs and sheep are eligible for quarterly payments if the average
margin in the quarter falls below a certain percentage of a five-year moving average for that quarter. The cow-calf program is similar, but payments are annual and based on a ten-year moving average.

**Marketing Boards for Hogs.** All but one province has a marketing board, commission or cooperative for selling hogs. The hog boards or commissions use either electronic auctions to establish prices or formulas with prices in other major Canadian and U.S. markets. None of these “agencies” exercises supply management powers. All of the boards are made up of producers elected by producers to operate on behalf of producers. Some of the provincial “agencies” are involved in export sales and product promotion.

**Meat Import Act.** The Canadian Meat Import Act provides for invoking import quotas on beef if imports exceed the average level during 1971–75, with an annual adjustment. It is like the U.S. Meat Import Law since it incorporates counter-cyclical supply provisions; when domestic supplies of beef decrease, import quotas expand. The act has been used only once, in 1985, against the European Economic Community (EEC) and never against the United States.

**Grain Transportation.** Canada’s grain sector, although essentially market oriented, is the object of several public policies.

Transportation assistance is provided to the grain sector with two major instruments, the Western Grain Transportation Act (WGTA) and the Feed Freight Assistance Program for provinces.

Under the WGTA, grains are moved from the Prairie provinces to the Great Lakes and Pacific Coast at legislated low rates. Railways are paid the difference between legislated rates and the estimated market rate, plus a portion of future increases in costs.

Feedgrains moved from the Prairies to Quebec, Atlantic Canada and British Columbia are subsidized up to C$15 million annually under the Feed Freight Assistance Program. In addition, the federal government contributes to the maintenance and rehabilitation of railway branch lines and purchases of equipment.

The WGTA has its roots in Confederation when the Western provinces were induced to become part of Canada with guaranteed low transport rates for Prairie grain. Feed Freight Assistance was initially introduced to help Eastern Canadian farmers produce meat for the British and Canadian effort during World War II.

**Canadian Wheat Board.** The Canadian Wheat Board (CWB) is a federal crown corporation that attempts to maximize producer earnings for certain grains (wheat, oats and barley) grown in the Prairie provinces (the CWB area); provide equitable access to markets for all producers; and provide some measure of price stability. The CWB has several powers at its disposal. It is the only marketing outlet for Prairie wheat, barley and oats traded interprovincially and internationally, and it licenses imports of wheat, oats, barley and other
grain products. It merchandizes wheat and feedgrains controlled by
the CWB. It provides for "price pooling" for wheat, oats and barley.
Producers receive a delivery quota that may be increased during the
crop year. An initial payment is made on the amount under delivery
quota once the CWB has an indication of what the average pooled
price to Canadian producers will be. Interim and final payments are
made if average pooled returns exceed the value of initial payments.
In addition, wheat sold for domestic consumption is assured a mini-
mum price of C$7 per bushel under Canada's Two-Price Wheat Plan.

Western Grain Stabilization Act. The Western Grain Stabilization
Act is designed to protect producers from instability in prices without
distorting market signals. Payments are made when the total cash
flow from the sale of seven grains (wheat, oats, barley, feed wheat,
flax, canola and rye) in a particular year declines below the average
of the previous five years. The federal government contributes 4 per-
cent of gross sales revenue from Prairie grains. Farmers who choose
to participate pay a premium of 2 percent of their revenue from grain
sales up to $60,000 annually. Payments are made on the basis of the
weighted average price of all seven grains, thus there is an incentive
to produce the grain that is expected to yield the highest profit.
Grains and oilseeds grown in Eastern Canada and outside the CWB
area are eligible for stabilization payments made under the national
Agricultural Stabilization Act of 1975.

Livestock and Grains: Public Goods. A variety of public good type
programs are used in the livestock and grain sectors including grad-
ing, Record of Performance, publicly funded research and health in-
spection.

Canada's grain grading system is operated under the Canada
Grains Act. The act specifies precise classifications and procedures
for handling grains. The high grade standards maintained by the
system allow Canadian wheat to be sold at a premium in world mar-
kets. The Canadian grain grading system is essentially a public
good; one that would not have evolved in the absence of government
involvement.

Grading of livestock is carried out pursuant to the federal Live-
stock Grading Program and the Agricultural Products Standards
Act. For hogs, carcasses receive an index number representing the
quantity of meat in the carcass based on its backfat in relation to
weight. The beef system is similar, but less precise. Grading pro-
grams benefit consumers as well as producers since they result in a
higher quality product.

Federal-provincial Record of Performance programs are designed
to measure genetic traits that are economically important and
aid breeding decisions. Agriculture Canada, provincial governments
and universities conduct research on most agricultural and food
commodities.
Partially Protected: Selected Horticultural Crops

Several policy instruments, often grouped under “orderly marketing” policies, are used in the horticultural sector.

Some of these instruments are among the most contentious in Canadian agriculture. For example, provincial liquor boards typically control which products are listed, the allocation of shelf space and the price markup. Generally, markups on wines produced in the province are lower than on imported wines. Similarly, most provinces have sourcing requirements to qualify for these markups.

Many Canadian fruits and vegetables are protected by seasonal tariffs. These tariffs are imposed at different levels at different times of the year and are applied on a regional basis, because the growing season for horticultural crops varies. The general intent of these tariffs is to protect local growers from declining prices due to earlier harvests further south. Of Canada’s tariffs on fruits and vegetables, twenty-two are higher than in the United States, twenty-two are lower and nine are the same (Harling et al., Chap. 4, p. 2). Some horticultural commodities are also eligible for stabilization payments under the ASA.

Among the instruments designed to aid in the “orderly marketing” of horticultural crops are grading requirements, shipping container standards and retail packaging and labeling standards.

International and interprovincial shipments of fresh and processed produce cannot be made in bulk containers without Agricultural Products Board permission. This essentially stops shipments to surplus areas.

Canada allows only specific container sizes for canned and frozen fruits and vegetables. This prohibits spot selling of some canned goods produced in the United States. Generally, frozen product can move freely because it is shipped in larger containers and then re-packaged. Product sold in glass containers must be in metric sizes. In addition, according to the Consumer Packaging and Labeling Act, all products sold in Canada must bear a bilingual, French and English, label.

Fully Protected: Supply Management

The production of dairy products, poultry and eggs is geared to Canadian demand. This involves managing domestic supplies and imports. Production quotas are used to limit supply to the amount demanded at a formula-determined selling price. In order to maintain this price, import quotas are required. Basic import quotas for poultry have been negotiated at a fairly low percentage of Canada’s domestic production.
In addition to the protection afforded by the supply management system, Canada’s industrial milk producers consistently receive large federal transfers.

The Main Conflicts

Several trade disputes between the United States and Canada in recent years indicate which elements of Canadian and U.S. agricultural policy are likely to be sources of conflict between the two countries. Others have not been the subject of disputes.

Canadian Policies

Stabilization. The 1985 “Hogs and Pork from Canada” dispute indicates that the United States interprets stabilization programs as providing countervailable subsidies. Under U.S. trade law, a program is deemed to be countervailable if it fails the specificity test, i.e., if it is provided to a specific industry or group of industries. The issue of whether a program provides a subsidy in the economic sense is not important in U.S. law. But in trade negotiations this issue must be addressed. Canada’s WGSA and ASA, including the Tripartite Red Meat Program, do not provide an economic subsidy since they do not induce a production response (Martin and Goddard). The reasons are that payments are retroactive, the amount of the future price guarantee is not known and payments are received too late. However, some of the provincial stabilization programs for hogs may provide economic subsidies and induce a supply response, thereby distorting natural patterns of production among Canadian provinces.

Public Goods. The “Hogs and Pork from Canada” case also indicates the United States may interpret several of Canada’s public-good-type programs as providing unacceptable subsidies. If the specificity test is used to determine which Canadian programs are acceptable to the United States, then federal-provincial Record of Performance programs may be viewed as unacceptable subsidies because only beef, dairy cattle, sheep, poultry and honey and honey bees are eligible. However, grading programs may be viewed as acceptable because “numerous agricultural products are similarly graded,” including grains (U.S. International Trade Commission, 1985). This is inconsistent. Both types of programs are available to suitable commodities. Both provide public goods and do not induce the production response required for an economic subsidy. The perversity of the specificity test makes it impossible to use in defining what constitutes an acceptable subsidy in Canada-U.S. trade negotiations.

Supply Management. Some of the practices associated with supply management, such as import quotas, production quotas and market
sharing, are welfare reducing and may minimize trade distortions. Although these are technically legal under the General Agreement on Tariffs and Trade (GATT), the United States may insist that Canada relax its import quotas in order to gain some access to the Canadian market. Provided that the United States gains some access to the Canadian market, it is unlikely to insist that Canada remove supply management completely. Also, because the United States intervenes in some of these sectors, dairy for example, it may be willing to accept supply management, perhaps with sliding import levies instead of import quotas.

**Transportation Assistance.** Public assistance provided to transporting Canadian agricultural products is unlikely to be tolerated by the United States, especially for grain. Canada and the United States compete in world grain markets. Therefore, the United States is unlikely to accept continued use of a transportation subsidy on an export oriented commodity. However, potential losses to Western producers could be offset by gaining more efficient access to world markets through the Mississippi and Columbia-Snake river systems.

**Canadian Wheat Board.** The monopoly/monopsony powers of the CWB may not be acceptable in principle to the United States but, since “price pooling” and “delivery quotas” do not distort international prices, the Canadian system may be perceived as being preferable to others such as the EEC’s. Consequently these instruments are not likely to cause a conflict. However, Canada will be pressured to abandon its two-price wheat policy and its practice of licensing grain imports.

**Discriminatory Practices: Wines and Grapes.** Discriminatory procurement, markup, listing and domestic content legislation in the Canadian wine industry is not likely to be tolerated by the United States. Wines imported from the United States and other countries would sell better if the current Canadian policy was dismantled. In addition, Canadian consumers would probably appreciate it.

**Orderly Marketing Instruments: Selected Horticultural Crops.** Canada’s domestic labeling, packaging and shipping container regulations are likely to be perceived as nontariff barriers to U.S. products. This may be correct in some cases, but certainly not all.

**Other.** Seasonal tariffs on selected fruits and vegetables may cause minor conflicts. Seasonal tariffs probably will be viewed as discriminating against U.S. products since they are imposed before the peak of the Canadian harvest, which coincides with the peak in U.S. supplies. The Meat Import Act is not likely to cause a conflict since it is similar to the U.S. Meat Import Law.
Selected U.S. agricultural policy instruments also are likely to cause conflicts between the United States and Canada. The provisions of the 1985 U.S. farm bill are the best example. This was the issue in the recent countervailing duty action brought against the United States by the Ontario Corn Producers' Association in “Corn from the U.S.A.” Since the United States accounts for a large proportion of world corn production, the target price of $3.03 induced an increase in world corn production despite payment limitations and acreage set-aside provisions. This increase in production resulted in lower world corn prices from which U.S. producers were insulated via deficiency payments ($1.84). But, since Canadian corn producers receive the world price, they were adversely affected by the U.S. farm bill. The status of the United States as a large country in world grain markets implies that its policy actions will affect Canadian producers. This reality also accounts for the impacts of the EEC-U.S. agricultural subsidy war on other Canadian grain producers, and the subsequent necessity of the Special Canadian Grains Program that was announced in 1986.

U.S. Trade Law Practices

Two aspects of the current U.S. trade law system are particularly “loathsome” to Canadians. The U.S. system is essentially concerned with placing tariffs on imports, fair and unfair imports alike. Several statutes that can be used to “block” imports are available to U.S. producers and most of the proceedings can be started only by a petition from U.S. producers. The legal requirements to have a formal investigation initiated are burdensome and once the investigation begins, the onus of proof is on foreign exporters. In addition, one statute enables U.S. producers to have their initial research paid for by the government while foreign exporters must pay for their own research and legal counsel. Thus, there are considerable costs involved for foreign exporters who attempt to protect themselves from harassing, rent-seeking behavior by U.S. producers.

U.S. Countervailing Duty Law. The test used to determine what constitutes a countervailable subsidy and the conditions required to impose a countervailing duty are the major complaints that Canadians have about U.S. countervailing duty law.

First, under U.S. law, a program is deemed to confer a countervailable subsidy if it is available to a specific industry or enterprise or group of industries or enterprises. The issue of whether the program confers an economic subsidy, a movement up or a shift in the supply curve, is not addressed. Ironically, some Canadian agricultural programs have been classified as countervailable by the U.S. Department of Commerce because they are targeted at specific types of producers in order to limit potential supply responses.
Second, and intimately related to the first complaint, is that under U.S. law the existence of a subsidy, as defined by U.S. law, and economic injury to domestic producers of the "like good" are sufficient conditions for imposing a countervailing duty. The third requirement that is spelled out in the 1979 GATT Agreement on Subsidies and Countervailing Duties, that there be a causal link between the subsidy and the injury, is not present in U.S. law.

**Options: Bilateral Negotiations**

Certain instruments of Canadian agricultural policy are open to negotiation with the United States. Probably this is the case for U.S. policy instruments also. The policy instruments currently used by the United States and Canada could be grouped into mutually acceptable, mutually nonacceptable and contestable instruments by the two negotiating teams. Canada and the United States could continue to use mutually acceptable instruments and would refrain from using mutually nonacceptable instruments. Special provisions probably would have to be made for the phasing out of mutually nonacceptable programs.

The contestable instruments could be dealt with in one of three ways. One possibility is to use a quantitative measure, such as a producer subsidy equivalent (PSE), of the total amount of subsidy provided for a commodity in both countries, calculating the net subsidy and countervailing the country with the higher subsidy by the difference.

The second possibility is to harmonize the existing contingent protection laws in both the United States and Canada by adding to U.S. law the provisions that already exist in the GATT Subsidies Code; a test for causality. If the United States insisted that the existence of a causal link among the subsidy, the increase in exports and injury to domestic producers of that product be proved before a countervailing duty was imposed, then the current dispute settlement mechanism could be followed.

The third alternative is to harmonize the two countries' contingent protection laws and establish a joint commission with the power to make binding decisions. From our point of view the latter option is preferable. Measurements such as PSEs and their contemporaries are riddled with difficulties and each of these concepts has limitations. The joint commission route would allow the economic analysis that is pertinent to the market to be conducted. It would also insure that trade disputes are divorced from politicians.

Canada would insist that the following policies be included in the group of mutually acceptable subsidies for the following reasons. Canada would insist on maintaining true stabilization programs such as the Western Grain Stabilization Act and Agricultural Stabi-
lization Act. These programs offer income protection against unanticipated changes in price movements but do not distort market signals or induce a supply response. Other "so-called" stabilization programs, such as many of the provincial hog programs, likely would be mutually nonacceptable.

Canada probably will insist on maintaining certain instruments used in the grain sector. The price pooling and delivery quota system of the CWB is not likely to be an issue because it is not trade distorting. The United States probably would insist that transportation subsidies, two-price wheat policy and import licensing, be eliminated.

Canada would insist on continuing programs that provide public goods such as grading and inspection, research, extension, education, market information and health and safety standards. The U.S. probably would agree that these programs are mutually acceptable.

Canada's supply management programs present a dilemma; however, the United States is almost certain to insist that Canada modify the import quotas that accompany the production quotas and market sharing features of supply management.

Ideally, programs such as the 1985 U.S. farm bill, and others that have the effect of driving down international commodity prices, should not be used by the United States. It is unreasonable to expect the United States to refrain from subsidizing its grain producers when the EEC continues to do so. The United States and the EEC must realize that as "large countries" their actions may do irreparable harm to small trade dependent countries such as Canada. This issue can only be satisfactorily settled in the multilateral negotiations.

But the United States can be fair in the application of its trade laws and this would help Canadian exporters and the Canadian agricultural sector a great deal. Many features of U.S. trade law could be amended to make it less of a rent-seeking system, but the countervailing duty statute is the most important to Canadian agriculture.

First, the United States should adopt an economic definition of subsidy. The current legal definitions are not useful in determining which foreign programs cause potential injury to U.S. producers.

Second, the United States should use a causality test to determine whether countervailing duties should be imposed on foreign exports. Causality is present by definition for export subsidies, but for domestic programs the issue of whether the subsidy caused an increase in exports, and ultimately injury to U.S. producers, must be considered explicitly. This would be consistent with the 1979 GATT Agreement on Subsidies and Countervailing Duties.

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