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The Search for “NAFTA Plus”



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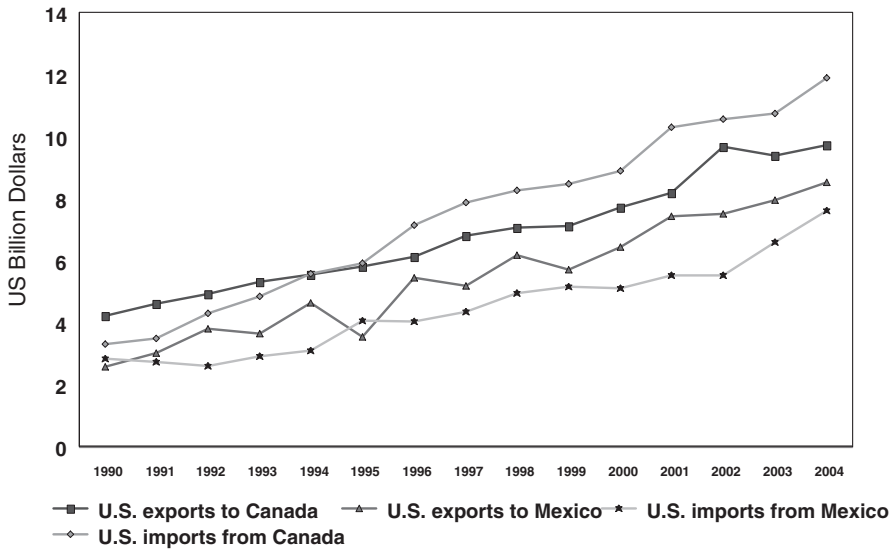
INTRODUCTION

More than 12 years after the initial implementation of the North American Free Trade Agreement (NAFTA) in 1994, agricultural trade among the Agreement’s signatories – Canada, Mexico, and the United States (US) – continues to grow at an impressive pace (figures 2.1 and 2.2). Between 1993 and 2004, this trade increased at a compound annual rate of 7.8 percent, surpassing \$39 billion in 2004. With NAFTA’s implementation nearly complete, however, there are concerns that the easy gains in economic efficiency and market integration have already been accomplished and that additional steps are necessary to ensure that further gains are achieved. This poses a distinct challenge to the NAFTA governments, since NAFTA and its predecessor accord – the Canada-US Free Trade Agreement (CUSTA), implemented in 1989 – did not create trilateral institutions with the supranational authority to facilitate the deepening of the new trading environment, in contrast to the European Economic Community when it was formed in 1958 (Harvey). In fact, it can be argued that the successful negotiation and approval of the two agreements was predicated on not creating strong supranational institutions.

What NAFTA did create was a set of mechanisms and organizational structures that preserved the national sovereignty of its member countries. To resolve disputes related to the Agreement’s investment and services provisions, the application of national antidumping (AD)

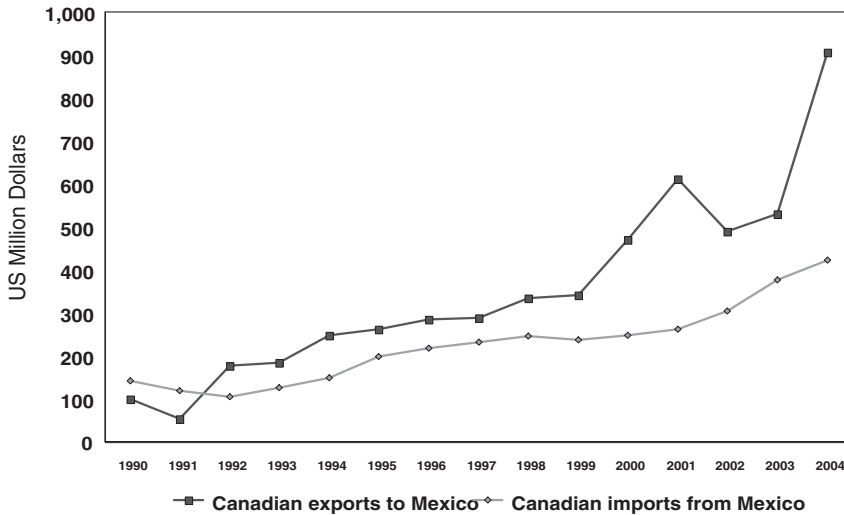
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Figure 2.1: US agricultural trade in the NAFTA region.



Sources: United Nations (Canadian data) and Foreign Agricultural Trade of the United States database.

Figure 2.2: Canada-Mexico agricultural trade.



Sources: United Nations (Canadian data) and Foreign Agricultural Trade of the United States database.

and countervailing duty (CVD) laws, and the Agreement's general interpretation, NAFTA established a number of formal dispute resolution mechanisms. To facilitate regulatory coordination among the NAFTA governments, the Agreement set up an extensive set of committees and working groups, some of which directly address issues related to the agrifood sector (Green et al.). To create additional opportunities for integration, the NAFTA governments mutually agreed to adjust the Agreement's rules of origin and expedite the implementation of some trade provisions.

Economic integration of the North American agrifood sector has proceeded at a brisk pace in this institutional setting. Continued population growth and sustained periods of economic expansion in each NAFTA country have bolstered consumer demand and forced new economic arrangements in the agrifood sector. In a policy environment in which trade is much freer and cross-border business activities are more secure, firms have reorganized their activities around continental markets for inputs and outputs. This development is visible not only in agrifood trade but also in cross-border investments, alliances among firms, and changes in the retail and transportation sectors. Legal and illegal migration flows from one NAFTA country to another continue to be substantial, and parts of the Canadian and US agrifood sectors rely heavily on foreign-born workers from Mexico and other countries.

Indeed, there is a clear sense that economic integration under NAFTA is outpacing the policy process. The NAFTA panels that review national AD and CVD determinations have by and large functioned as intended, overturning some determinations and affirming others, but the completion of panel operations and implementation of panel decisions are taking much longer than the official timelines suggest. Moreover, because there are no clear rules aligning the dispute resolution processes of NAFTA and the World Trade Organization (WTO), a temptation exists for the losers of one dispute resolution process to seek a costly "do-over" under the other process. A small number of disputes have had extremely long lives. Notable examples include the Canada-US softwood lumber dispute,² the Mexico-US sugar and sweetener disputes, and the successful challenge at the WTO to the US Byrd Amendment.³

In the regulatory arena, mid-level officials and policy specialists from the NAFTA governments work together on technical agrifood issues on a regular basis within the context of NAFTA's committees and

² In September 2006, Canada and the US finalized a market sharing agreement to govern softwood lumber shipments from Canada. This apparent conclusion to a decades-long dispute opens questions as to the role of voluntary export restraints within a free trade area.

³ The Byrd Amendment to the US Tariff Act of 1930 awarded antidumping and countervailing duties, previously deposited in the US Treasury, to US producers who supported the trade remedy actions that resulted in these duties.

working groups. But serious regulatory conflicts have required the active participation of high-level officials and the creation of new administrative structures, such as the bilateral consultative committees on agriculture, to direct and manage policy initiatives (Green et al.). Unusually difficult regulatory issues of the recent past – such as bovine spongiform encephalopathy (BSE) (Leroy, Weerahewa, and Anderson; Sparling and Caswell) and the Salmonella outbreaks linked to Mexican cantaloupes during 2001-03 (Green et al.) – have not been forgotten by the parties adversely affected by those events, even though the response of the NAFTA governments to these crises eventually led in the direction of greater policy coordination.

The difficulty in managing economic relations among the NAFTA members has led some people in both government and the private sector to call for additional government actions to build upon NAFTA. These actions would lead to the formation of what is sometimes referred to as “NAFTA Plus.” Many of the more developed proposals have come from Canadian groups, such as the Canadian Council of Chief Executives and the C.D. Howe Institute,⁴ but observers from each NAFTA country have offered ideas about what should follow NAFTA (Council on Foreign Relations; Saldaña). However, not everyone has climbed aboard the NAFTA Plus bandwagon, and several recent books sharply critical of further integration (Barlow; Faux) have had strong sales in Canada and the US. In Mexico, some groups are advocating the renegotiation of NAFTA’s provisions for corn and beans. Nevertheless, the level of economic integration in North America has become so great that even many of NAFTA’s critics have recognized that the likelihood of completely undoing this process is close to nil (Jackson).

This chapter considers what could be done to advance and improve integration in the North American agrifood sector. Because these ideas build upon the integration already achieved under NAFTA, we think of them as potential elements of NAFTA Plus. The chapter is organized as follows. The next section outlines the main options for deeper integration, while subsequent sections focus on specific areas in which further integration could take place, including trade policy, domestic agricultural policies, dispute resolution, regulatory coordination, and the labor market. The final section summarizes the chapter’s main points and offers conclusions.

⁴The Canadian Council of Chief Executives is a not-for-profit, non-partisan organization composed of the CEOs of Canada’s largest companies with total annual gross revenues exceeding C\$750 billion annually. The C.D. Howe Institute is a national, nonpartisan, nonprofit organization that aims to improve Canadians’ standard of living by fostering sound economic and social policy.

OPTIONS FOR DEEPER INTEGRATION

Regardless of what governments do, the deepening of North American economic integration will continue through initiatives in the private sector. The big question is whether the NAFTA governments will try to get in front of the process, and if so, how? For people interested in the agrifood sector, there is another important question: What role will the sector play in the deepening of North American integration? Hufbauer and Schott argue that agriculture is the make-or-break issue for both multilateral and regional trade agreements, despite the fact that agriculture only accounts for about ten percent of total merchandise trade among the NAFTA countries.

Several factors complicate the pursuit of further integration in the North American agrifood sector. First, each NAFTA member maintains its own agricultural policy, and the resulting policy differences have led to a variety of trade disputes, as well as considerable subsidy envy in Canada and Mexico following the passage of the 2002 Farm Security and Rural Investment Act (US Farm Act) (Barichello, Josling, and Sumner; Hufbauer and Schott; Meilke and Sarker; Thompson; Wainio, Young, and Meilke).

Second, agriculture is the only sector where significant tariff and quota barriers will remain on trade within the NAFTA region after the Agreement is fully implemented. These exceptions primarily stem from CUSTA, which excluded several important commodities from the process of Canada-US trade liberalization: US imports of Canadian dairy products, peanuts, peanut butter, cotton, sugar, and sugar-containing products and Canadian imports of US dairy products, poultry, eggs, and margarine.

Third, the task of creating NAFTA Plus will necessarily compete with other pressing issues for the attention of decision-makers – particularly in the US, where security concerns have predominated for the past five years. In her seminal essay, Dobson argues that only a “Big Idea” will capture the attention of US policy-makers. She proceeds to outline three Big Ideas: 1) a customs union; 2) a common market; and 3) a “strategic bargain” in which the US and Canada pursue deeper integration without relinquishing national sovereignty. In Dobson’s view, Mexico would be involved in these efforts “when practical,” and Mexico and the US would be expected to work on improving their bilateral relationship at the same time that Canada and the US were addressing their bilateral concerns. Below we describe a number of economic alternatives available to the NAFTA members including each of the Big Ideas suggested by Dobson.

Doing Nothing

Doing nothing is an extremely unappealing option, especially for Canada and Mexico. First, US security concerns have the potential to conflict with cross-border economic activities (Lukas). This is not in the economic interests of any NAFTA country, and a trilateral approach to security and trade is an obvious area for cooperation. Second, the increasing willingness of the US to enter into bilateral and regional trading arrangements with countries outside NAFTA reduces the tariff preferences enjoyed by Canada and Mexico. While Mexico has made similar arrangements with many of these countries, Canada generally has not, and this may diminish Canada's attractiveness as a site for business operations linked with the rest of the global economy. Third, if multilateral trade negotiations do not bear fruit in the near future, then a deepening of the NAFTA relationship may be the easiest avenue toward the improved economic efficiency required to meet increased competition from China, Brazil, and elsewhere. Finally, a successful conclusion of the Doha Development Agenda is likely to place additional constraints on agricultural policies, which might facilitate moves by the NAFTA countries to reduce expenditures on trade-distorting support programs.

Strategic Trilateralism

The NAFTA governments are already pursuing the strategic bargain suggested by Dobson, and this approach has the potential to make important contributions to integration if pursued in a sustained fashion. Over the past several years, the NAFTA governments have worked to provide a stronger trilateral structure for the programming and implementation of policy coordination, with an eye on the much broader economic and security dimensions of the Canada-Mexico-US relationship. In March 2005, the NAFTA governments unveiled the Security and Prosperity Partnership for North America (SPP), in which they pledged to "develop new avenues of cooperation that will make our open societies safer and more secure, our businesses more competitive, and our economies more resilient" (Joint Statement by President Bush, President Fox, and Prime Minister Martin). Ten different working groups operate under the SPP's umbrella, and one of these is responsible for agrifood issues.

An implicit part of the strategic bargain is the notion that economic integration will be driven primarily by market forces and private interests. Thus, the formal role of the NAFTA governments in agrifood integration currently is limited to regulatory coordination, dispute settlement through existing NAFTA and WTO panel processes, and ad hoc arrangements to address specific agrifood issues.

Strategic Trilateralism in the Direction of a Customs Union

This approach assumes that the NAFTA governments do not immediately pursue the establishment of a customs union but instead make trade policy changes in concert that would approximate the circumstances of a customs union. Such an initiative would involve the harmonization of selected external tariffs, the elimination of some but not all rules of origin, and attempts to harmonize domestic policies. Harmonization does not imply that policies are identical, but it might represent mutual recognition of each of the other country's procedures. It might involve the creation of NAFTA-specific institutions without strong supranational powers, such as an organization to coordinate animal and plant health issues or a joint economic analysis unit. It might also involve a series of sectoral accords where integration would proceed more quickly in some industries, on either a bilateral or trilateral basis. One goal of this approach would be to lay the groundwork for the creation of a customs union at some point in the future.

A Customs Union

A customs union could be either "shallow" or "deep." A shallow customs union would require the adoption of common external tariffs, elimination of rules of origin on NAFTA trade, and the elimination of the remaining tariff barriers on agrifood trade. A deeper customs union would have common rules concerning administered protection (i.e., antidumping and countervailing duties) that apply to third country trade but not to NAFTA trade, agreement on the sharing of revenues obtained from tariffs and administered protection, and a common approach to the trade preferences extended to developing countries. Formation of a customs union in North America would require the NAFTA countries to address some difficult issues, including the treatment of Cuba, the harmonization of tariff rates with developing countries where the NAFTA members have established preferential tariff regimes, and the need to create at least some new supranational institutions.

A Common Market

Creation of a North American common market would require the free flow of goods, capital, and people within the NAFTA region, as well as the establishment of common economic policies and supranational institutions. Through their trade and investment provisions, CUSTA and NAFTA have done a great deal to facilitate the free flow of goods and capital among the NAFTA partners. But the prospects for formally integrating the labor markets of the NAFTA countries and thus achieving a common market in the immediate future are dim. Immigration reform is a highly contentious issue in the US, and the comfort level of Canada

and Mexico with a unified labor market has not been established. These arguments lead us to the conclusion that strategic trilateralism in the direction of a customs union – where deeper economic integration is achieved by the NAFTA countries without undermining political autonomy – is the most realistic short-term alternative for achieving greater integration in the North American agrifood sector. This would involve unilateral moves by individual NAFTA members that are consistent with the formation of a customs union and cooperation in areas where there are mutual gains. The remainder of this chapter focuses on what we see as essential and doable within such a strategic bargain.

TRADE POLICY

Trade flows are the most obvious conduit for further integration. Since most of the gains associated with tariff elimination and the reduction of trade barriers among the NAFTA countries have already been achieved, any further improvements in efficiency would require deeper integration. A movement toward the next level of integration, a customs union, would entail the adoption of a common external tariff, harmonization of external trade policies, the sharing of customs duties, and compatible customs procedures.

A common external tariff would have two broad effects. First, lowering external tariffs to the lowest level among the three members would increase efficiency. Second, a common external tariff would eliminate the need for rules of origin and the transactions costs associated with those procedures. All free trade agreements (FTAs) have rules of origin in order to prevent non-member countries from taking advantage of the concessions made by the FTA's members by exporting goods to the member country with the lowest tariff and then transshipping those products to the member countries with higher tariffs. Restrictive rules of origin increase administrative costs, complicate border inspections, decrease trade and investment, and lessen the predictability of the policy environment for cross-border economic activities (Goldfarb).

Rules of origin are costly because governments incur administrative costs to implement them and traders incur compliance and extra production costs to meet their requirements. Some exporters choose to pay the nonpreferential Most Favoured Nation (MFN) duties rather than incurring the extra costs of proving origin. In a study of a potential customs union involving Canada and the US, Ghosh and Rao find that eliminating NAFTA's rules of origin in all sectors could increase Canadian GDP by 1.1 percent and US GDP by 0.1 percent.⁵ The same study finds

⁵ The model captures the allocative inefficiency of diverting trade from nonNAFTA members to members, thereby distorting input choices from low-cost to high-cost sources. To capture these inefficiencies, the authors lower the MFN rates to the NAFTA rates in Canada, Mexico, and the US. The average reductions are 2.11 percentage points in Canada, 0.6

that the largest impact from a customs union comes from removing restrictive rules of origin (82 percent of the total effect) rather than harmonizing tariffs (18 percent of the total effect).

However, we are not convinced that rules of origin are an important impediment to NAFTA agrifood trade. We suspect that rules of origin are only a minor problem in agricultural trade because most agricultural products are produced with inputs that are sourced within the NAFTA region. An agricultural product is specified to originate in the NAFTA countries when it is grown, harvested, wholly produced, or substantially transformed there. For agricultural goods, substantial transformation occurs when processing causes a product to shift from one tariff classification to another (US Department of Agriculture, Foreign Agricultural Service, 2005).⁶ A number of food and agriculture-related products, however, face potential problems with rules of origin: peanut-based products, sugar-based products, dairy products, vegetable oils, citrus juices, manufactured tobacco products, and textile fibers.

The NAFTA tariff utilization rate is the proportion of the trade of a product that takes place using NAFTA preferences divided by total trade of that product between two NAFTA members. Several studies – Kunimoto and Sawchuk (2005); Goldfarb; and Cadot et al. – provide estimates of utilization rates for agricultural products that are less than 75 percent. Low utilization rates may indicate that exporters are avoiding the added transaction costs of complying with rules of origin. However, given the calculation method used in these studies, low utilization rates may also reflect a large number of MFN duty free imports in the denominator of the utilization ratio. Our understanding is that if MFN imports not subject to duties are removed from the calculation, the utilization rates will approach 100 percent – indicating that the costs of complying with rules of origin are not a significant trade barrier.⁷

How feasible is it to move to a common external tariff? The practicality of this reform depends on the number of tariff provisions that the NAFTA members would reconcile. Coordination would involve aligning: 1) MFN tariffs across the three member countries; 2) the generalized preferential tariffs that are applied to developing countries; 3) FTAs that members have signed with countries outside NAFTA; and 4) special rates applied to countries with which members do not maintain normal trade relations.

percentage points in the US, and 5.72 percentage points in Mexico.

⁶ This definition of substantial transformation is less restrictive than other criteria such as minimum value added and other detailed technical requirements. On this basis, the rules for agriculture are less restrictive than for other sectors.

⁷ Discussions with John Wainio, senior agricultural economist with USDA's Economic Research Service, suggest utilization rates of 99-100 percent for US agricultural imports from Canada and Mexico. The use of NAFTA tariff utilization rates as a proxy for costs of rules of origin is not an effective measure to the extent that rules of origin cause trade diversion with respect to agricultural inputs away from third country markets.

Table 2.1: Selected MFN tariffs by member.

	Canada	US	Mexico
Live cattle	0%	1%	15%
Live swine	0%	0%	23%
Beef carcasses (fresh)	26%	26%	20%
Pork carcasses (fresh)	0%	0%	20%
Hams (fresh or chilled)	0%	0%	20%
Chickens (fresh/chilled)	238%*	5%	240%
Butter	299%*	91%*	20%
Cheddar	246%*	38%*	20%
Wheat	1%**	3%	67%
Corn	0%	0%	198%*
Barley	1%**	2%	118%*
Potatoes	1%	2%	251%*
Apples	0%	0%	23%
Raspberries	0%	5%	23%
Soybeans	0%	0%	15%
Canola/rapeseed	0%	2%	0%
Sugar beet/cane	6%	90%*	100%
Crude soyoil	%	19%	10%
Crude rapeoil	6%	6%	10%
Malt extract	36%	10%	10%
Uncooked pasta	0%	0%	10%
Strawberry jam	13%	2%	45%
Other peanuts	6%	132%*	23%

Source: Inter-American Development Bank (IADB).

Notes: * Over-quota tariffs.

** In-quota tariffs.

Specific tariffs have been converted to *ad valorem* equivalents by using unit import values.

The more coordinated the MFN tariff lines are between member countries, the easier it should be to convert to a common tariff structure. Canada's average MFN tariff is 4.4 percent versus 4.6 percent for the US. Furthermore, many of the MFN tariff lines involve duty free trade (49 percent of Canadian tariff lines and 35 percent of US tariff lines) (Kunimoto and Sawchuck 2004). So from an aggregate perspective, Canada and the US do not have a great distance to go in forging a common schedule of MFN tariffs. However, the devil is in the details, with over 8,000 tariff lines that would have to be reconciled.

As always, agriculture presents an obstacle to liberalization. The largest tariff differences among the NAFTA countries are in agricultural

Table 2.2: Simple average tariffs by chapter (2002).

Chapter	Category	Canada	US	Mexico
1	Live Animals	1	1	14
7	Edible vegetables and roots	3	9	19
8	Edible fruits and nuts	1	5	22
9	Coffee, tea	1	1	26
10	Cereals	14	2	49
11	Product of milling industry	4	4	21
12	Oilseeds	1	8	7
15	Animal / vegetable fats and oils	5	1	21
16	Preparations of meat	17	4	23
18	Cocoa and cocoa preparations	4	6	19
19	Preparations of cereals, flours	4	9	16
20	Preparations of vegetables	6	11	23
21	Misc. edible preparations	7	8	33
22	Beverages, spirits and vinegar	7	2	27
24	Tobacco and products	7	91	51

Source: Inter-American Development Bank (IADB).

products. Table 2.1 illustrates some of these differences for a selection of commodities. Although dairy is an import-sensitive sector in both Canada and the US, Canadian dairy tariffs range from 200 to 300 percent, while US tariffs are less than 100 percent. The US and Mexico each treat sugar as a sensitive product with tariffs roughly equal to 100 percent, compared with six percent in Canada. Both Canada and Mexico treat poultry as a sensitive sector, with tariffs roughly equal to 240 percent, compared with 5 percent in the US. Other sensitive sectors are unique to the member country: US peanuts (130 percent) and tobacco (350 percent), and Mexican maize (200 percent). Aggregating tariff lines reduces some of the differences among the NAFTA members, but even at the two digit HS tariff chapter level, significant differences persist in the MFN tariffs. Table 2.2 illustrates simple averages of the *ad valorem* tariffs for selected tariff chapters.

Large differences in MFN tariffs are not the only challenge that a common trade policy regime would present; negotiators also would have to harmonize the entire tariff rate quota (TRQ) mechanism for sensitive products. This would involve establishing a common quota volume and reaching agreement on administering preferential access. Mexico notified 11 TRQs to the WTO, Canada notified 21, and the US notified 54 (WTO, 2000). Table 2.3 illustrates the number of products that have been notified as TRQs by each NAFTA member.⁸ The beef sector is an example of a partially coordinated trade policy by Canada and the US. Both countries

⁸ Each “product” in table 2.3 might have several tariff lines associated with it.

Table 2.3: Tariff rate quotas by country.

Canada	US	Mexico
Broiler hatching eggs	Beef	Poultry meat
Chicken, live and meat	Milk and cream	Pig and poultry fat
Turkey, live and meat	Butter	Dried milk
Beef and veal	Dried milk	Hard and semi-hard cheese
Fluid milk	Dairy mixtures	Potatoes
Cream	Evaporated/condensed milk	Beans
Concentrated milk	Dried whey	Wheat
Yogurt	Butter oil substitutes	Barley
Powdered buttermilk	Cheese (8 types)	Corn
Dry whey	Green whole olives	Coffee
Other milk constituents	Peanuts	Sugar
Butter and dairy spreads	Sugars, syrups and molasses	
Cheese	Raw cane sugar	
Other dairy	Cocoa powder	
Ice cream	Chocolate crumb	
Eggs and products	Infant formula	
Wheat	Mixes and dough	
Barley	Peanut butter and paste	
Wheat products	Satsuma	
Barley products	Mixed condiments	
Margarine	Ice cream	
	Animal feed containing milk	
	Tobacco	
	Cotton	

Source: World Trade Organization (WTO).

have notified a beef TRQ to the WTO and employ an over-quota tariff of 26.5 percent. It would be possible, but not easy, to establish a common quota volume. However, as there is only partial overlap in the number and types of TRQs, aligning these measures across members would be problematic.

Given the significant problems associated with negotiating market access for sensitive agricultural products at the WTO, it is unlikely that any form of complete MFN tariff harmonization or a common approach to applying and administering existing TRQs would be possible. Harmonizing preferential tariffs applied to developing countries complicates the development of a common external tariff because Canada and the US provide preferential access to different sets of developing countries. Furthermore, the countries where Canada and the US do not maintain normal trade relations also differ: Canada does not have normal relations with Libya and North Korea; while the US lacks normal relations with Cuba and North Korea.

One of the biggest problems with harmonizing trade policies involves the many different FTAs that the NAFTA members have negotiated. All three countries have signed FTAs with Chile, Costa Rica, and Israel, but these agreements contain different obligations. Mexico has the broadest set of FTAs including the European Union, the European Free Trade Association, and Japan. It also has signed bilateral agreements with Chile, Bolivia, Costa Rica, and Nicaragua; with Venezuela and Colombia; and with Guatemala, Honduras, and El Salvador. The US has negotiated FTAs with Australia, Bahrain, the countries of the Central America Dominican Republic Free Trade Agreement (Costa Rica, Dominican Republic, Guatemala, Honduras, Nicaragua, and El Salvador), Chile, Jordan, Morocco, Oman, Peru, and Singapore, and it is negotiating additional agreements with Colombia, Ecuador, Malaysia, Panama, the South African Customs Union, South Korea, Thailand, and the United Arab Emirates. A full customs union would require the reconciliation of the rules of origin used in each FTA.

A common trade policy is not the only method to facilitate trade flows between member countries. Another approach would be to streamline and reduce the need for routine customs clearance. Concerns with national security and increased vigilance can impede trade flows and everyday commerce. To reduce the possibility of this occurring, the US secured “Smart Border” agreements with Canada in December 2001 and Mexico in March 2002. Although these documents are largely action plans for identifying and addressing risks, several specific programs are involved. The Advance Commercial Information (ACI) program is a Canadian program that requires the electronic provision of information about incoming air and marine cargo shipments to the Canada Border Services Agency 24 hours in advance of shipping. The Free and Secure Trade (FAST) program, which involves all three NAFTA countries on a bilateral basis (Canada-US and Mexico-US), streamlines border crossing for low-risk commercial traffic. The FAST program facilitates the movement of preapproved goods across the border through preapproved importers, carriers, and registered drivers. Inspections and compliance are established away from the border. The intent of FAST is to reduce uncertainty and accelerate the process of clearing the border while reducing the cost of compliance (Canadian Border Services Agency). Preclearance programs that move the point of inspection to the location of production should free up border inspection resources for policing security issues. To date, however, there is not much information on the efficacy of the preclearance program.

Is further integration with respect to harmonizing trade policy possible? At their annual meeting in 2006, the NAFTA trade ministers called for a review of measures to improve the benefits that duty free access can

provide. Included among the measures under review are rules of origin. The NAFTA Working Group on Rules of Origin has already made progress in reforming these measures over the last two years, and further reforms are expected (US Department of State). In terms of a common external tariff, the NAFTA countries already have a de facto sectoral customs union with respect to certain data-processing equipment so that exporters do not have to establish the origin of their products (Goldfarb).

With these promising antecedents, what degree of integration can be expected? Since there are a number of trade sensitive sectors in both manufacturing and agriculture, a sectoral approach is probably the best that can be expected. Where tariff rates are close and reform is politically feasible, it may be possible to develop a common trade policy. In beef, Canada and the US already have a common external tariff. Further reform could include harmonizing TRQs or creating a common tariff for other meats in addition to beef. Where public policy might be the most useful is in streamlining border procedures. If border security costs create large impediments to trade, the incremental gains from a customs union may be small. Moving inspections back from the border could free resources for increased border security.

A North American customs union would almost certainly involve bringing those agricultural commodities excluded from NAFTA's original project of trade liberalization more fully into the agreement (Huff, Meilke, and Wigle). Eliminating tariff and quota restrictions on these commodities could take place gradually, perhaps over a 15-year period, and if this reform were to be pursued now, it would subject these commodities to competitive pressure within the NAFTA region prior to the end of the next round of multilateral trade negotiations. While this change would be fought by vested interests, it may be preferable to having these industries be unprepared for competition from outside the NAFTA region. Several possible alternatives are consistent with liberalization, and these are considered in more detail by Barichello, Cranfield, and Meilke.

DOMESTIC AGRICULTURAL POLICIES

The requirement to harmonize domestic policies is only associated with an economic union, so lower levels of integration such as a customs union do not require any attempt to synchronize policies. Gifford (p.34) states that "NAFTA is not predicated on common policies. Instead specific commitments are undertaken and it is presumed that members will make the domestic policy changes necessary to bring them into conformity with the trade agreement provisions." Nonetheless, ever since the signing of CUSTA, a number of commentators have called for some form of farm policy convergence. Part of the motivation for these calls to action is a perceived disparity in the level of support going to the farm sector of

Table 2.4: Value and composition of producer support in NAFTA, 2004.

	Canada		Mexico		US	
	Bil. Dol.	Percent	Bil. Dol.	Percent	Bil. Dol.	Percent
Value of Production	24.2		29.8		225.4	
Producer Support Estimate (PSE)						
Market price support	2.6	46.5	2.4	44.5	16.1	34.8
Payments based on output, area planted, animal numbers or input use	1.3	22.3	1.8	33.1	15.5	33.4
Payments based on historical entitlements or input constraints	0.6	10.2	1.2	22.4	12.8	27.6
Payments based on overall farming income	1.2	20.7	-	-	2.0	4.3
Other	0.1	0.3	-	-	-	-
Total PSE	5.7	100.0	5.4	100.0	46.5	100
General Services Support Estimate (GSSE)						
Research, development and agricultural schools	0.5	29.8	0.3	41.0	2.8	8.1
Infrastructure	0.4	21.0	0.1	10.7	6.0	17.5
Marketing, promotion and inspection services	0.9	49.2	0.4	47.3	22.8	66.7
Other	-	-	0.0	1.0	2.5	7.7
Total GSSE	1.8	100.00	0.8	100.0	34.1	100.0
Total of PSE and GSSE	7.5		6.3		80.6	
PSE (percent of total)		21.0		17.0		18.0
GSSE (percent of total)		7.4		2.7		15.1

Source: OECD, 2005.

each NAFTA member (Loyns, Knutson, and Meilke 1995, 1998; Loyns, Meilke, and Knutson; Loyns et al. 1997, 2001; Thompson). This raises several questions:

- 1) Are support levels dramatically different among NAFTA members?
- 2) If support levels are different, does it matter to integration?
- 3) What are the pressures for and against policy harmonization?
- 4) Is the harmonization of domestic agricultural policies practical?

The usual measure of farm subsidies is the Producer Support Estimate (PSE) prepared by the Organization for Economic Cooperation and Development (OECD 2005). In 2004, Canada provided its farmers with support and protection equal to 21 percent of the farm value of production; comparable numbers for Mexico and the US were 17 and 18 percent, respectively. Table 2.4 describes domestic support of the NAFTA members. The aggregate transfer includes a number of measures which may or may not be directly received by farmers and may or may not affect production decisions. The OECD disaggregates the support estimates to provide a better indicator of how government programs may affect production and markets.

First, the General Services Support Estimate (GSSE) is an annual monetary transfer to agriculture but not to individual producers. This transfer is generally associated with the provision of services whose benefits are broadly shared such as research, inspection, marketing,

and promotion. These programs are frequently associated with Annex 2 of the WTO Agreement on Agriculture (alias the “green box”), since the measures are generally assumed not to affect production decisions directly and are considered to be minimally trade-distorting. Table 2.4 shows that the absolute level of GSSE spending is considerably higher in the US than in Mexico or Canada, even on a proportional basis. Provision of these goods lies at the heart of a nation’s sovereign right to develop policy and deliver programs. While there may be economies of scale resulting from common NAFTA funding and delivery of agricultural services with broad benefits, harmonization in this area would require close cooperation among the NAFTA governments in an area where they have rarely worked together in the past.

The PSE consists of two elements: 1) the difference between domestic and world prices multiplied by the amount of the commodity produced (market price support), and 2) budgetary transfers. In aggregate, Canada and Mexico have higher shares of market price support than the US, but the distribution of budgetary transfers versus market price support varies by commodity (table 2.4).⁹ Typically, trade analysts view the discipline of market price support in a multilateral context as an issue to be dealt with by the domestic support and market access disciplines of the WTO Agreement on Agriculture. For this reason, it is unlikely that the effects of policy instruments, as measured by market price support, would be addressed through integration efforts of a regional trade agreement. However, a common external tariff should significantly help to harmonize the effects of market price support.

Budgetary transfers are paid to farmers based on “what they produce, the area of land farmed, or to input suppliers to compensate them for charging lower prices to farmers” (OECD 2004, p.4). These payments either can be based on current utilization or on historic rates or entitlements. Payments based on historic levels cannot be affected by producer behavior and the logic is that farmers should not change their behavior to get more of these payments. As a consequence, these fixed transfers have been recognized as potentially less distorting (WTO Agreement on Agriculture, paragraph 6, Annex 2). Roughly one-third of US transfers are based on historic entitlements (table 2.4). A smaller share of Mexican and Canadian transfers are based on this fixed criteria (22 and ten percent, respectively). In Canada, policy reform has involved moving away from commodity specific programs to payments based on overall farm income

⁹ US government expenditures are focused on grains and oilseeds, while livestock products receive little direct support (table 2.5). Mexican government support is likewise skewed towards crops with the 57 percent PSE for oilseeds being particularly high. Canadian government support for crop producers is generally well below that of the US. The high PSE for beef (25 percent) in Canada is atypical (up from 12 percent in 2002) due to government support programs that responded to the BSE crisis in 2003 (LeRoy, Weerahewa, and Anderson). All three countries provide considerable support to their milk producers, primarily through border measures.

Table 2.5: Producer support estimates, by commodity, 2004, percent.

Commodity	Country		
	Canada	Mexico	US
Corn	24	25	27
Oilseeds	16	57	24
Sugar	-	42	56
Wheat	13	24	32
Beef	25	7	4
Milk	52	29	39
Pork	8	2	4
Poultry	4	8	4

Source: OECD (2005).

(21 percent), while only a small share of the transfers are made as fixed historic entitlements (table 2.4). Mexico and the US transfer one-third of their payments either to current production or input use (table 2.4).¹⁰ Therefore each member has taken a different route to policy reform. Although subject to debate, many of the reforms move in the direction of being less distorting. But the routes taken by each country take different forms: generally available programs (Canada) versus fixed payments (US and Mexico). Therefore, convergence of policies is unlikely, given that the governments view their sovereign right to make policy as unalienable and consider their own reforms to have been in the right direction. The lesson that we take away from this review of support levels is that a country's philosophy towards farm policy, the instruments used to implement farm policy, and public perceptions will limit the potential to develop more common domestic agricultural programs under the NAFTA.

Even with institutional differences among the three countries restraining a convergence in policy, there are similarities that can contribute to an informal harmonization. Specifically, each government operates a "countercyclical" program that provides additional support when commodity prices (or net farm revenue, in the case of Canada) decline (Zahniser, Young, and Wainio). These programs do not just stabilize income; they also have a significant support element that transfers income to producers. Thus, significantly higher commodity prices over an extended period of time may reduce the size of countercyclical payments. The Food and Agriculture Policy Research Institute (FAPRI), which is traditionally conservative in its price projections, is forecasting a nearly 30 percent increase in the price of corn over the next five years. Much of the increase is predicated on rapidly expanding demand for corn by US ethanol producers, rising from 1.6 billion bushels in 2005/06 to 2.6 billion bushels in 2010/11, an increase of 66 percent.

¹⁰ The OECD recognizes these types of payments as more distortionary.

Stronger grain prices could provide an opportunity to modify farm programs and permanently lower support levels. Under FAPRI's assumptions, net outlays of the US Commodity Credit Corporation could fall from \$20.8 billion in 2006 to \$14.8 billion in 2011. However, what goes up in commodity markets can also come down, as the second half of the 1990s so rudely reminded farmers and agrifood policy-makers. The political willingness to impose permanent reductions in support on the agricultural sector has been difficult to maintain.

Another factor that could contribute to informal policy harmonization is a successful conclusion of the Doha Development Agenda. Improved market access and reduced tariffs should (somewhat) reduce the market price support element of each member's domestic support. Harmonization formulas for reduction of domestic support will target US domestic programs. To the extent that any new disciplines bite, the US may have to consider minor modifications to its agricultural policies.¹¹ Given the nature of the US and Canadian policy-making processes, any changes made to domestic agricultural programs are likely to be formulated and implemented on a unilateral basis. A new multilateral agricultural agreement is unlikely to force Mexico to modify its farm programs, as that country has ample room for additional expenditures under its current ceiling on trade-distorting agricultural support. In addition, Mexico designates itself as a developing country at the WTO. Thus, Mexican commodities classified as "special products" may be exempted from further tariff liberalization as part of a new agreement.

Over the next several years, the NAFTA governments will make substantial changes to their domestic agricultural programs. Only three years ago, Canada introduced the Canadian Agricultural Income Stabilization (CAIS) Program, and plans are now afoot to either reform or replace this program. The Mexican Congress is considering a legislative proposal that would create a new multiannual framework for Mexico's farm programs, and the country's new president, who took power in December 2006, may chart a new course in Mexican agricultural policy. US policy-makers are already working on the successor to the 2002 Farm Act, and in 2005, the US government solicited extensive public comments about the possible direction of this legislation.

None of the potential changes mentioned above resemble a movement by the NAFTA countries toward a common agricultural policy or even increased coordination of their domestic agricultural policies. Thus, farm policy initiatives in the immediate future are likely to be taken up on a unilateral basis. One unattractive option that NAFTA members could pursue would be to increase support on an individual commodity basis to the highest level provided by the NAFTA countries – a race to the top.

¹¹ Brink predicts that even with new disciplines none of them will bind.

Indeed, Mexico already is devoting greater resources to its countercyclical program, the Subprogram of Direct Supports to Target Income, which was implemented partially in response to the 2002 US Farm Act (Zahniser 2006). While a race to the top might be attractive to the recipients of such support, the major result would be higher asset values, higher cost structures, and potential conflicts with the disciplines of the WTO. Moreover, it might make the NAFTA countries less competitive with emerging low-cost suppliers of agrifood products in other parts of the world.

Given these considerations, possible policy modifications that could move the NAFTA countries in the direction of a customs union and make the region more competitive in the international marketplace include:

- 1) Common applied external tariffs on all agricultural and food products, with the possible exception of those commodities classified as “sensitive” in the WTO negotiations. This could be accomplished by reducing the applied tariff of each NAFTA country to the level of the lowest bound tariff among the NAFTA members. By keeping bound tariffs unchanged, no negotiating room in the WTO would be lost.
- 2) Gradual elimination of all domestic support tied to the current production of specific commodities or to the use of specific inputs, perhaps over a ten-year period. Making program expenditures on a fixed historical and perhaps declining base, as well as shifts to whole farm programs are possible elements of this approach.
- 3) Joint operation and cost sharing of programs relating to infrastructure, marketing and promotion, inspection services, and other areas. Such an effort would encourage industries in the NAFTA countries to consider the free-trade area as their relevant “domestic” market and non-NAFTA countries as their shared export market.
- 4) Cooperation in providing transition programs to farmers who are displaced by changes in farm policy. This effort could contain a special focus on poor rural households in Mexico.

DISPUTE SETTLEMENT

Specifying a mutually agreeable method to settle disputes was one of the more difficult aspects of the CUSTA and NAFTA negotiations. During the CUSTA negotiations, Canada sought a new trading regime that would have sharply limited the use of administered protection.¹² Canada was not successful in this effort, but in the “decision at midnight,” the two countries accepted the historic compromise of allowing binational panels

¹² AD actions are brought against firms in foreign countries that are selling in the import market at prices below those charged in the home country, or below their full cost of production including a margin for profit. A CVD action is brought by domestic producers against foreign producers who are alleged to benefit from unfair government subsidies.

to review administered protection rulings rather than national courts of appeal (Hart, Dymond, and Robertson). The issue was revisited during the NAFTA negotiations, but in the end, NAFTA essentially adopted the procedures found in CUSTA.¹³

Unlike the WTO, which has one dispute settlement “path,” NAFTA contains six separate dispute settlement processes, each of which is tailored to a different set of issues (table 2.6). Further complicating matters, some disputes are adjudicated at both the WTO and NAFTA, and in several instances, cases have been contested in both venues simultaneously. With respect to AD and CVD determinations, the NAFTA members retain the right to appeal findings either through the binational NAFTA panel process or through national appellate courts, but not both.

In order to limit this discussion, we focus our comments on the administered protection rulings that are the purview of Chapter 19 of NAFTA. Few economists view AD laws as having a solid grounding in economic theory, and the economists’ fan club for CVDs is not much bigger (Boltuck and Litan; Ikenson; Kerr; Meilke and Sarker; Stiglitz). Nevertheless, administered protection is enshrined in both NAFTA and the WTO. Public perceptions of the extent to which agrifood trade disputes arise among the NAFTA countries often do not match reality. Fortunately, there are two reviews of agrifood disputes (Wainio, Young, and Meilke [WYM]; and Barichello, Josling, and Sumner [BJS]) as well as Hufbauer and Schott’s general summary of all disputes to help set the record straight.

A starting point for addressing the effects of AD/CVD determinations is to ask how many products are currently subject to AD duties or CVDs. It may be surprising to some observers that as of 16 February 2006, the US had only eight AD/CVD orders in place against Canada (none of which were on agrifood products) and 12 against Mexico (only one of which was on agrifood, and that one was suspended). Contrast this with 60 orders in place against China (six on agrifood) and 20 orders against Italy (two on agrifood). Similarly, as of 31 March 2005, Canada had six orders in place against the US (three on agrifood) and two against Mexico (none on agrifood).

Of course, the number of orders in place at a particular point in time underestimates the economic costs of trade disputes because the number does not capture the expectations that a case will be filed, the cost of any preliminary duties imposed, and the huge legal expenses of defending against an administered protection case, even if the exporter “wins” the

¹³ Our discussion is limited to trade in goods. Trade in services, investment measures, and government procurement also figured prominently in the CUSTA negotiations. The importance of dispute settlement for agrifood products was an early concern, as illustrated by a conference held at the University of Guelph in 1987 (University of Guelph).

Table 2.6: NAFTA dispute settlement provisions.

Provision	Purpose	Use	Decision Method	Remedy
NAFTA, Chapter 11	To settle investor-state disputes over property rights	13 active cases, 12 previous arbitrations	Three member tribunal	Monetary relief to the winning party. Arbitral awards are final and national governments are required to enforce the findings.
NAFTA, Chapter 14	To settle disputes in the financial sector	None	Three member panel	Can suspend benefits in the financial services sector.
NAFTA, Chapter 19	To determine if antidumping and countervailing duty determinations by national administered protection agencies are consistent with their national laws. Procedure substitutes for appeals through national courts.	31 active cases, 77 completed cases	Five member panel	National administered protection agencies are required to reconsider their decisions in light of the panel's findings. Final compliance rests with the national administered protection agencies.
NAFTA – Chapter 19 – Extraordinary Challenge Procedure	Appeal process for Chapter 19 NAFTA panel findings. Grounds for appeal are: bias or gross misconduct by a panel member; panel seriously departed from a fundamental rule of procedure; or panel manifestly exceeded its powers.	3 completed cases	Three judges or former judges	The committee's decisions are binding and require reconsideration of national administered protection agencies decisions so they are not inconsistent with the panels ruling.
NAFTA, Chapter 20	To resolve government-to-government disputes regarding NAFTA's application and interpretation.	3 panels	Five member panel if it reaches arbitration	Panel offers non-binding recommendations.
NAFTA, North American Agreement on Environmental Cooperation	To mediate environmental disputes where there has been a persistent pattern of failure to enforce environmental law	No cases	Arbitral panel	Panel can require implementation of action plan to ensure enforcement of environmental laws. Failure to comply can lead to suspension of NAFTA benefits.
NAFTA, North American Agreement on Labor Cooperation	To ensure each member enforces its labor laws	31 cases submitted to national administrative offices	Committee of experts and an arbitral panel	Fines or suspension of trade benefits (Mexico and US) for disputes dealing with child labor, minimum wages, and occupational safety.
World Trade Organization	To determine if NAFTA members rules, procedures, and findings are consistent with WTO rules and commitments		Three person panel chosen from a permanent roster of persons who are not citizens of countries party to the dispute	Bring offending measure into compliance with ruling; pay compensation or face suspension of benefits.

Source: Hufbauer and Schott.

case. After examining the record of trade disputes between 1982 and 2002, WYM (pp. 1050-51) came to the following conclusions:

- 1) When trade in all goods is considered, the NAFTA countries were subject to far fewer investigations by other NAFTA countries than import shares might suggest.
- 2) The agricultural sectors of the NAFTA countries have utilized AD/CVD laws more frequently to contest imports from other NAFTA countries than to contest imports from nonmember countries.
- 3) Only 12 percent of investigations by NAFTA countries of nonagricultural imports were directed at other NAFTA countries, compared with 37 percent of investigations of agricultural imports.

Over a more recent time period (1989-2003), BJS (pp. 1-4) report these findings:

- 1) The annual number of Canada-US agricultural disputes was constant, but the ratio of the number of disputes to the value of bilateral agricultural trade fell by at least one-half.
- 2) As measured by complaints to domestic authorities, Canada-US trade disputes are disproportionately high in agriculture.
- 3) Although agriculture is fertile ground for trade disputes compared with nonagricultural trade, Canada-US trade is no more contentious than US and Canadian trade with other countries.
- 4) Most Canada-US agricultural disputes arise from competitive frictions rather than major policy or institutional differences.

The two reviews show that trade disputes among NAFTA members on goods trade are lower than their trade shares would predict, but that agriculture accounts for a disproportionately high number of the disputes. The explanation for WYM's finding that the NAFTA countries are more likely to contest imports from bloc countries and BJS's opposite finding is likely due to the inclusion of data from the early 1980s in the WYM study that is excluded in the BJS study. It is also important to note that some trade disputes involving a small subset of commodities never seem to go away. The most glaring example is the softwood lumber dispute between Canada and the US, which persisted for more than 20 years, prior to the market sharing agreement signed in September 2006.

Based on this summary, it could be argued that agrifood trade disputes among the NAFTA countries have been blown out of proportion. Using historical data for actual AD/CVD cases, it is difficult to identify an increasing level of protectionism. Unfortunately, it takes only a few high profile disputes to turn public opinion against freer trade. In addition, while the economic costs of trade disputes may be small in relation to the total value of trade, the costs can be devastating to the firms and

workers directly involved in those disputes. As Stiglitz notes, “the filing of harassment cases intended to impose purely temporary trade restraints and legal costs on foreign exporters...are particularly effective because of the asymmetries in legal costs borne by domestic plaintiffs and foreign defendants.” These actions threaten the goal of a free trade area where products are expected to move as easily among countries as they do within countries so that the benefits of trade and specialization can be fully realized.

For these reasons, it is important to examine current trade remedy laws to see if they could be modified to lessen their effects on trade flows. Three alternatives to the current dispute settlement provisions are discussed in rising order by degree of ambition: 1) quick fixes to current procedures; 2) a step beyond current procedures; and 3) total replacement of administered protection on NAFTA trade.

Quick Fixes to Current Procedures

The goal of Chapter 19 in NAFTA is to provide a more impartial and faster review of administered protection decisions than is possible using domestic courts. Under the rules of Chapter 19, panels have 315 days to submit their final decisions, but Hufbauer and Schott report that no panel has met this deadline and NAFTA decisions average around 700 days. Much of the delay revolves around the initial formation of panels. Drawing upon the work of Herman; Hufbauer and Schott; and Macroy, we identify several possibilities for making the dispute settlement provisions of NAFTA work faster and better.

First, there could be a single NAFTA Secretariat, a single NAFTA headquarters, and a common staff, funded by each member government. Second, there could be a mutually agreed roster of panelists that handles all NAFTA disputes and receives remuneration sufficient to attract the best minds. Third, to the extent that there are differences in the NAFTA members' interpretation and application of WTO administered protection laws, the Secretariat could work to help harmonize these views. Fourth, the NAFTA Secretariat could be bolstered by creating an economic analysis division, which would have as its objective the analysis of key economic policies in the member governments from a NAFTA perspective. Such a division would provide increased transparency of government actions and illuminate the trilateral effects of policy instruments. For example, a comprehensive trilateral analysis of grain and oilseed policies in the NAFTA members could contribute greatly to the policy debate in this area. The NAFTA economics division would have to operate at arms length from the member governments but be responsive to requests from member governments for research, as well as monitoring policy developments in each nation. If the member governments were willing,

all of these changes could be made quickly, make the current system work better, and not infringe in any way on national sovereignty.

A Step beyond Current Procedures

To move beyond the changes suggested above would require more than cosmetic changes to administered protection laws. A first step might be to negotiate a number of sectors that would waive their rights to use administered protection laws against NAFTA members.¹⁴ For example, it has been extremely rare for an agrifood trade dispute to involve a finished food product – an antidumping duty on US baby food shipments to Canada being a rare example. A second step would be to adopt WYM’s suggestions to “tweak” the administered protection rules as they apply to NAFTA trade by: 1) increasing the *de minimus* level; 2) increasing the level of negligible imports; 3) restricting the size of the duty to the level sufficient to address injury instead of the full amount of the dumping or subsidy margin (Moschini and Meilke; Van Duren); 4) changing the calculation of the duties to account for the subsidy practices of the industry bringing the case; and 5) requiring an evaluation of the impact of duties on the general interest of the free trade area.

A third step would be to develop different rules for agricultural products than for manufacturing products. Loyns (2006) argues that current AD rules are ill-suited for agriculture and should be set aside completely or modified to better fit the unique characteristics of agriculture. At the very least, these rules could take into account the fact that agriculture is a cyclical industry and that “dumping” prevails at the bottom of nearly every production cycle when the standard of comparison is market price versus the full cost of production. Since these cycles are common to the three NAFTA members and the likelihood of predatory pricing in primary agricultural products is small, major changes to AD rules could be implemented to limit their application to primary agricultural trade. The case for maintaining the right to levy CVDs is somewhat stronger because the farm subsidies of one NAFTA government can have harmful effects on producers in other NAFTA countries. The use of a higher *de minimus* standard and a higher threshold for establishing injury should sharply reduce the number of successful undertakings.

A fourth step that could reduce the number of administered protection cases and their associated economic costs would be to give the economic analysis division of the NAFTA Secretariat the power to determine if a case has enough merit to move forward and if preliminary duties should be collected. Although national administered protection agencies could still “try” the case, it would remove from domestic industries the almost

¹⁴ The actual negotiations would presumably involve tariff lines that would not be subject to administered protection actions.

unconstrained right to have their cases heard. This proposal is bound to be controversial since it would take power away from national administered protection agencies by ceding it to a supranational body.

Total Replacement of Administered Protection under NAFTA

Before NAFTA can evolve into a customs union, the member countries will have to eliminate the use of administered protection laws on intra-bloc trade. MacLaren and Josling suggest that a common competition policy is the logical replacement for AD actions. Currently, a Florida firm that ships tomatoes to Michigan can be engaged in a common business practice that is judged to be “unfair” if the product then moves across the border from Michigan into Ontario. If industries are organized on a NAFTA basis, as is the case with nearly all industries upstream and downstream from primary agricultural production, then concerns about anticompetitive behavior could also be tackled on a NAFTA basis using common definitions and rules concerning mergers, acquisitions, and anticompetitive behavior.

To convince the NAFTA members to give up antidumping measures and at least limit the use of countervailing duties, Hufbauer and Schott have suggested the creation of a special agricultural safeguard. The idea is a simple one: in the event of an import surge, a temporary “snapback” to some positive tariff level would be implemented.¹⁵ Such a safeguard would have several advantages: 1) there would be no requirement or need to judge the imports as “unfair;” 2) the rules and the remedy would be transparent; 3) if the exporting firm has control of the shipments, it could increase prices to avoid the imposition of the duty and capture the rents associated with the duty, rather than having the importer capture the rents; and 4) the snapback duties would be time-limited. A safeguard would address BJS’s contention that more trade disputes result from competitive frictions (import surges) than from policy differences.

Still, great care would have to be taken in specifying the parameters of the safeguard measure to ensure that it was less trade disruptive than the AD/CVD measures it was replacing. Two examples make this clear. The first deals with the definition of an import surge – should this be ten percent, 25 percent, or perhaps 50 percent? The second deals with the question of to what level the tariffs, many of which are currently zero, should snapback. The snapback tariff could be set equal to the importing country’s MFN tariff rate, but these rates are often very high for agrifood commodities, and in some instances they differ substantially across the NAFTA members.

¹⁵ The snapback provisions could also be triggered by a decline in import prices. Grant and Meilke analyze the use of a WTO special agricultural safeguard mechanism for developing countries.

REGULATORY COORDINATION¹⁶

The NAFTA governments have actively pursued regulatory coordination in the agrifood sector throughout the NAFTA period. The text of NAFTA specified the creation of an extensive set of committees and working groups, and several of these committees have focused on the coordination of regulatory issues concerning the agrifood sector, including the Committee on Sanitary and Phytosanitary Measures and its constituent working groups and the Working Committee on Agricultural Grading and Marketing Standards. Many of these committees and working groups continue to meet, and over the years they have made important contributions to economic integration. But the NAFTA governments also have pursued regulatory coordination in other venues, sometimes as a substitute for the NAFTA committees and working groups.

Green et al. identify two major approaches to regulatory coordination by the NAFTA governments. “Workaday cooperation” encompasses the day-to-day interactions of the NAFTA governments and usually features the rank-and-file staff and mid-level managers of the agriculture, environment, and trade ministries of each government. In contrast, “strategic bilateralism” describes the efforts of higher-level officials to provide more top-down leadership, sometimes by forming new organizational structures such as the consultative committees on agriculture and often in response to more contentious issues. Because regulatory issues tend to be bilateral in nature, “strategic trilateralism” has been less common than “strategic bilateralism,” and workaday cooperation usually involves only two countries at a time.

Given the complexity of the subject matter and the significant public health, environmental, and economic concerns at stake, regulatory coordination is rarely easy. But by bringing their collective expertise and leadership to bear, the NAFTA governments have accomplished much in the area of regulatory coordination for the agrifood sector.

Examples include:

- 1) a common trinational approach to the mitigation of risks associated with BSE;
- 2) a phytosanitary framework that allows for the export of fresh Hass avocados from certain municipalities in the Mexican State of Michoacán to the entire US by 2007;

¹⁶ Regulatory coordination was one of the main themes of the 2005 NAAMIC Workshop (Huff et al.). This section draws in part on a background paper prepared for that workshop by Green et al.

- 3) contingency plans by Canada and the US in case there is another outbreak of potato wart;
- 4) the sharing of scientific studies, administrative evaluators, and the like by pesticide regulators of the NAFTA governments (this practice is called “work sharing”); and
- 5) a memorandum of understanding between Mexico and the US that allows for the differentiated treatment of prospective Mexican cantaloupe exporters based on the producer’s food safety record.

As stated in the introduction, the NAFTA governments are striving to provide an even stronger framework for the programming and implementation of policy coordination through the Security and Prosperity Partnership for North America (SPP). As part of the SPP, the NAFTA governments established a Food and Agriculture Working Group, whose agenda encompasses seven major initiatives on regulatory coordination (table 2.7). The group’s activities are guided by a detailed work plan, replete with over 60 “milestones” to be accomplished, timelines, and status reports. These elements reflect a long-run vision (one to two years) of what the member governments intend to accomplish, a short-term plan of action (usually less than one year) that specifies and schedules the next steps to be taken, and performance standards and evaluations (the milestones and status reports) to assure that the long-term vision is fulfilled.

Progress in implementing the work plan varies by initiative, depending in part on the extent to which the initiative builds upon pre-existing activities and organizational structures. For instance, efforts to resolve differences in pesticide maximum residue limits and to conduct joint reviews of pesticides (initiative 1.3) are crisply defined and well on their way to completion, in large part because they incorporate activities of the NAFTA Technical Working Group on Pesticides, one of the working groups within the NAFTA Committee on Sanitary and Phytosanitary Measures. The SPP also draws upon pre-existing initiatives of the North American Plant Protection Organization (NAPPO) and the North American Biotechnology Initiative (NABI), two organizations whose activities overlap those of the NAFTA committees and working groups.

The funding concerns of one or more NAFTA governments are another factor that determines the direction and pace of regulatory coordination, with less well-funded initiatives tending to stall. The establishment of a plant health laboratory network to identify equivalent methodologies for the detection, identification, surveillance, and risk assessment of plant diseases and pests (initiative 2.2) has been put on hold due to funding uncertainties, and funding issues also have been raised about aspects of initiatives 1.1, 1.2, and 2.3. The challenge for the NAFTA governments is to be selective in setting the agenda for regulatory coordination, giving

Table 2.7: Initiatives and selected accomplishments and activities of the SPP's Food and Agriculture Working Group.

Initiative	Key Accomplishments	Selected Ongoing Activities
1.1. Establish or identify a North American food safety coordinating mechanism to facilitate the cooperative design and development of common standards (where appropriate), the review of existing food safety standards with a view to removing differences (where warranted and appropriate), and the sharing of information on food safety matters.	The Working Group assigned this task to itself (January 2006) and drafted a list of standards to review (March 2006).	In addition to reviewing standards, the Working Group is exploring ways to coordinate activities better within Codex Alimentarius.
1.2. Cooperate on a North American basis to speed up identification, management and recovery from food safety, animal and plant disease hazards.	Creation of harmonized North American import approach to management of BSE (June 2005). Completed propagative material standard for plant protection (October 2005).	Pilot program is underway to issue plant health certificates electronically. Countries are reviewing protocols for transit of animal products through another country and the designation of disease-free zones.
1.3. Resolve differences in pesticide maximum residue limits that may be barriers to trade and undertake joint reviews of pesticide registrations	Collaborative data collection on pest control products for "minor crops" (most fruits, vegetables, and nuts; September 2005).	Joint reviews of pest control products for "minor crops." Development of long-term trade-irritant-and-risk reduction strategy for pulses.
2.1. Work co-operatively within the established North American Foreign Animal Disease laboratory network to identify methodologies and recognize equivalent diagnostic performance and identification methodologies for select animal diseases, such as bovine espongiform encephalopathy (BSE) and Avian influenza.	Training course for Mexican laboratory diagnosticians on bovine tuberculosis (September 2005).	Contacts established to identify methodologies and recognize equivalent diagnostic performance for certain animal diseases.
2.2. Establish a plant health laboratory network to identify equivalent methodologies for the detection, identification, surveillance, and risk assessment of plant diseases and pests.	Initiative delayed due to funding concerns.	
2.3. Identify appropriate group or vehicle to facilitate implementation of food safety laboratory initiatives such as to assess and recognize equivalence, as appropriate, of analytical methods based on agreed method performance criteria and to enhance quality assurance for priority areas of food safety hazards	Implementation of Food Emergency Response Network course for microbiological and chemical disciplines (June 2005)	Identification of appropriate group or vehicle is underway. Participation of all three countries in general laboratory procedures and courses offered by Canada and Mexico.
3.1. Continue cooperative effort within North American Biotechnology Initiative (NABI) for initiation, coordination and prioritization of various biotech activities	NABI participants have discussed steps for pilot program for transboundary movement of genetically modified corn (September 2005).	Canada-U.S. regulatory exchanges to be expanded to include Mexico; training workshops to be held in Mexico for risk assessors.

Source: Security and Prosperity Partnership, Food and Agriculture Working Group.

priority to those projects that can be both feasible and have a meaningful impact, and in large part working within existing budget allocations. But the creation and operation of new trinational institutions to support regulatory coordination, such as the plant health laboratory network envisioned by the Food and Agriculture Working Group, is likely to require additional planning and perhaps an infusion of additional funds.

Even with the creation of the SPP, regulatory coordination by the NAFTA countries continues to be an exercise of national sovereignty and thus falls squarely within the strategic bargain outlined by Dobson. Each country retains the right to determine the appropriate level of protection for its

citizens and its plant and animal resources and to design and implement the measures necessary to achieve that level of protection. The big question regarding the future of North American regulatory coordination is whether the NAFTA countries would at some point be willing to entrust some aspects of regulatory coordination to a supranational institution. So far, the NAFTA governments have expressed little interest in such an endeavor.

IMMIGRATION AND THE LABOR MARKET

NAFTA has had an important direct and indirect impact on factor markets through the elimination of tariff and quota barriers, but the Agreement generally does not address the cross-border movement of people within the NAFTA region. One important exception to this rule is Chapter 16 of NAFTA, but that chapter focuses on the temporary visits of business persons and professionals and has nothing to say about the temporary visits of other workers or the more permanent moves of migrants. Judging from the hundreds of thousands of persons who travel from one NAFTA country to another each year for the purposes of employment, it is clear that the labor markets of the NAFTA countries already have undergone a substantial degree of integration. Because of public concerns about the size of legal and illegal immigration to the US and security concerns about the ease with which potential terrorists could enter the country, US policy-makers are considering major changes to immigration law and its enforcement which would affect this integration.

Cross-border movements of workers may be divided into three main categories: 1) persons who receive legal residency status from the host country; 2) persons who receive permission to work temporarily in the host country; and 3) undocumented migration. The latter category includes not only persons who entered a country illegally, but also legal entrants who obtain employment in violation of the terms of their entry visas. In each NAFTA country the laws and regulations governing immigration are by and large separate from NAFTA, and in most instances, they predate the Agreement.

Each year, the US and Canada grant legal or permanent residency to thousands of people from their fellow NAFTA countries. In Fiscal Year 2005 (October 2004-September 2005), the US granted legal residency to over 1.1 million people. Of these, 14 percent were born in Mexico and two percent were born in Canada (Jefferys and Rytina, p.3). Similarly, Canada granted permanent residency to nearly 236,000 people in 2004. The US was the country of origin for five percent of these individuals, while Mexico was the country of origin for less than one percent (Citizenship

and Immigration Canada). Not all of the persons who become legal residents intend to work in their host country, at least not immediately. Examples include spouses who do not work outside of the home, minor-age children, and senior citizens. Nevertheless, the long-term effect of granting residency to so many people is a substantial shift in labor from one NAFTA country to another. The largest component of these movements is people moving from Mexico to the US.

Both Canada and the US operate programs that allow for the temporary employment of nonimmigrant foreigners in the agrifood sector. In the US, the H-2A temporary agricultural program “establishes a means for agricultural employers who anticipate a shortage of domestic workers to bring nonimmigrant foreign workers to the US to perform agricultural labor or services of a temporary or seasonal nature” (US Department of Labor, Employment, and Training Administration). In Fiscal Year 2004, the US admitted over 22,000 workers as part of this program (US Department of Homeland Security, Office of Immigration Statistics, p.103). Thus, the H-2A program satisfies only a small portion of US demand for agricultural labor. In Canada, the government operates the Caribbean Commonwealth and Mexican Seasonal Agricultural Workers Program. More than 10,000 Mexicans participated in the program in 2002, generating some \$80 million in remittances. The terms of work under the program are not to exceed eight months at a time, although many workers participate from one year to the next. Producers of fruits, vegetables, and tobacco are among the program’s beneficiaries. In addition, the Mexican government instituted an agricultural visitor program in 1997 that allows Guatemalans to perform farm work in the State of Chiapas, which directly borders Guatemala. This program allows for multiple border crossings and seems to allow for the long-term employment of its participants (Secretaría de Gobernación, Instituto Nacional de Migración).

Of particular concern in the US are the substantial flows of undocumented migration, particularly from Mexico. Because undocumented migration is not legally sanctioned, there are no statistics available to measure the size of this phenomenon with a high degree of accuracy. A recent estimate placed the undocumented population in the US at roughly 12 million in March 2006 (about four percent of the total population), with 56 percent of undocumented persons originating in Mexico (Passel). In contrast, Canada’s undocumented population is estimated to be about 300,000 persons, or less than one percent of the total population. Few of these individuals are believed to be from Mexico. In turn, Mexico is a conduit for undocumented migration from other parts of the world, including Central America, and there are undoubtedly undocumented persons working in Mexico.

The number of undocumented persons employed by the US agrifood sector is not known with any greater precision. In 2005, US agriculture employed an average of about 1,047,000 farm workers, based on quarterly estimates from USDA's National Agricultural Statistics Service, and this number fluctuated from a low of 749,000 in January to a high of 1.3 million in July. Data from the US Department of Labor's National Agricultural Workers Survey suggest that about one-half of the hired labor force in crop agriculture is undocumented (Carroll et al., p.7). The food processing and food service industries are also believed to employ a substantial number of undocumented persons. In 1999, the US government implemented an initiative called Operation Vanguard with the aim to deport persons working without legal authorization in the meatpacking industry, but the operation was suspended following complaints from meatpackers, the Hispanic community, and the Social Security Administration (Migration Dialogue).

The US Congress is considering a number of legislative proposals in the area of immigration. These proposals share a common aim to restrict undocumented migration and the employment of undocumented migrants in the future, but they offer different approaches to the undocumented migrants who are already in the US (Martin). A bill passed by the House of Representatives in December 2005 – the Border Protection, Antiterrorism, and Illegal Immigration Control Act (H.R. 4437) – would not provide undocumented persons with any “amnesty” or legal residency (US House of Representatives), while several proposals advanced in the Senate would give them the opportunity to apply for guest worker visas and perhaps citizenship (depending on the proposal) under certain circumstances. As of December 2006, the House and the Senate had not yet forged a compromise.

For the undocumented workers who already work in the US agrifood sector and the firms that employ them, any change that would legalize their employer-employee relationship would have a number of benefits. Entering the US illegally can be a costly and dangerous undertaking. Over the last decade, thousands of persons from Mexico and other countries have died while trying to enter the US from Mexico. In Fiscal Year 2005, 472 persons perished in this fashion, according to statistics from the US Border Patrol (US Government Accountability Office). Many perils arise from the stark landscape – deserts, mountains, and rivers – that migrants traverse in order to avoid detection by US authorities. In order to increase their chances for success, many migrants hire the services of professional people smugglers known as “coyotes.” The charge for a coyote's services runs in the neighborhood of \$2,000 per crossing, and interacting with this illegal industry presents additional risks to the migrant, including rape, robbery, and abandonment. Thus, for undocumented migrants, gaining

the ability to work legally in the US would eliminate the transaction costs and tremendous dangers associated with illegal migration and facilitate casual trips by the migrant across the border to visit family and so forth.

For the employer, legalization would assure the continued services of their undocumented employees, for some time at least, and remove the possibility of legal sanctions for employing undocumented migrants, especially if the enforcement of immigration laws is intensified. Over the past year, a number of producers and producer organizations have expressed concern that they will not have sufficient laborers, particularly during key stages of the production cycle, and have cautioned against tighter immigration restrictions and more vigorous enforcement of immigration laws. Such concerns are not new, of course, and have been expressed for the better part of the last century. Nevertheless, some observers have cautioned that the competitiveness of some portions of the US agrifood sector stems from migrant labor (Green et al.).

There are several challenges in addressing the issue of undocumented migration. First, there is widespread acknowledgement among social scientists who study international migration that such migration is a cumulative process driven in part by the formation of migration networks (Massey et al.; Taylor; Sprouse; Zahniser 1999). A migration network consists of those persons among a prospective migrant's friends, relatives, and other contacts who possess the ability to lower the costs and risks of migration or to provide contacts with respect to employment, housing, and other subjects in the migrant's intended destination. Since successful migrants often become resources in this fashion for future migrants, a guest worker program or amnesty for undocumented migrants could quite possibly lead to additional migration – legal or illegal – in the future.

Second, the differences between persons on opposite ends of the US immigration debate are almost impossible to reconcile. On one extreme are persons who are highly critical of the large size of legal and illegal immigrant flows to the US. Many of these persons feel shortchanged by the current level of enforcement of immigration laws and are strongly opposed to any program that would extend legal immigration status to persons currently in the US illegally. On the other extreme are persons who have few reservations about granting legal immigration status to a large group of workers with extensive roots in the US. While there is room for policy-makers to forge an agreement, any bargain in the area of immigration law and its enforcement, strategic or not, is guaranteed to disappoint someone profoundly.

CONCLUSIONS

NAFTA is about to conclude one important phase of its existence and begin another. The implementation of NAFTA's agrifood provisions will be complete on 1 January 2008, so any subsequent actions to advance the process of market integration in the North American agrifood sector will have to come from something other than the text of NAFTA – actions that would form NAFTA Plus.

This chapter has examined several possible avenues for building NAFTA Plus in the agrifood sector, with the notion that work in some of these areas could form the strategic bargain among the NAFTA countries that Dobson suggests. During NAFTA's second decade, commercial interests are likely to lead further market integration in the North American agrifood sector, while government's main role is likely to be the creation of the physical, legal, and institutional infrastructure needed to facilitate the freer exchange of goods, services, and labor. Most of these actions are likely to be taken on a unilateral basis, but with close consultations and some coordination, they could move the member governments closer to establishing a customs union.

Agriculture will continue to be a difficult sector in which to make progress. This stems from the fact that some primary producers view their markets as being largely domestic rather than trilateral. In addition, protectionist sentiments run deep in each NAFTA country. Domestic agricultural programs were designed when agrifood trade among NAFTA members and international agrifood trade as a whole were a small fraction of what they are today. Still, at an aggregate level, the support provided directly to producers by the NAFTA members is similar, as are tariffs at an aggregate level. All three countries have devised income support programs that contain a countercyclical element and are at least partially decoupled from production decisions. It also appears that each member nation will be mounting a biofuels program in an effort to diversify away from petroleum-based products. In each of these areas, as well as in the development and funding of WTO "green box" programs, cooperation and consultation among the NAFTA members would seem crucial.

If the eventual goal is to form a customs union, the NAFTA countries need to begin the process of reducing external tariffs to the lowest level among the NAFTA members and to simplify rules of origin. In order to facilitate adjustment, the external tariffs for sensitive products might be initially exempted. These few remaining exceptions to free trade within NAFTA need to be addressed and brought into the fold, perhaps with a long phase-in period. Government support programs judged to be trade-distorting in the WTO will be under increasing international pressure for elimination, and the NAFTA countries could move ahead of the field

by eliminating these programs over the next decade. At the same time, transitional assistance programs should be examined carefully to see if they provide the appropriate amount and form of support required by individuals exiting the industry or adjusting to new market conditions (Barichello, Cranfield, and Meilke; Blabey; Orden).

With large and growing trade flows among the NAFTA members, trade disputes are bound to emerge. While a legitimate case can be made that the problems associated with trade disputes have been overblown, it is also true that a few high profile disputes have the potential to sour the entire trading environment and inflict large costs on affected industries. NAFTA contains a number of dispute settlement provisions and processes. Merging these processes into a single dispute settlement path, coupled with a NAFTA Secretariat and tribunals that are sufficiently funded to provide quality decisions in a more timely fashion, could help to ease tensions associated with integration. In addition, a NAFTA economic analysis division could examine economic problems and issues from a NAFTA perspective and provide greater transparency for complex agrifood policy issues.

Regulatory coordination will continue to be a challenging area, but there are a number of initiatives underway that have the potential to facilitate trade. It would appear that regulations will continue to be addressed primarily through workaday cooperation. Still, NAFTA's working groups need to receive support from senior officials and sufficient funding to make it possible for them to complete the tasks they are assigned.

Freer movement of labor among the NAFTA countries is controversial and concerns far more than the agrifood sector. At present, professional workers can move relatively easily among the member countries, while less skilled workers face huge barriers. Some types of primary agricultural production and food processing rely heavily on foreign, sometimes seasonal workers. Programs to facilitate the movement of these individuals among NAFTA members and at the same time reduce illegal immigration will again require cooperation.

Given the strong reservations of some North Americans about unifying the continental labor market and implementing a common agricultural policy, the idea of a North American common market is well ahead of its time. One should not forget, however, that many observers thought that a free trade area encompassing Canada, Mexico, and the US was out of the question not that long ago. If NAFTA eventually evolves along the lines of the European Union, first into a customs union and then into a common market, the agrifood sectors of Canada, Mexico, and the US will have many opportunities to play a proactive role in further integration.

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