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A North American Free Trade Area for Agriculture

The Role of Canada and the U.S.-Canada Agreement

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The U.S.-Canada Free Trade Agreement (CFTA) was enacted January 1, 1989, after two and a half years of negotiations. It predates the current negotiations to create a North American Free Trade Agreement (NAFTA) by expanding the CFTA to include Mexico. Participation in a NAFTA is important to Canada in order to maintain its status under the CFTA and to ensure its exports to the United States are not displaced by Mexican products. Canadian grains, oilseeds, beef, and pork exports would likely benefit from improved access to the rapidly growing Mexican market.

The June 1990 announcement that the United States and Mexico would create a comprehensive free trade agreement prompted Canada's September 1990 announcement that it desired to participate as a full member in the negotiations. The negotiations were formally announced in February 1991. Such an agreement among the three countries would encompass 360 million people and $6 trillion of economic output, eclipsing the European Community by over 30 million people and $1 trillion.

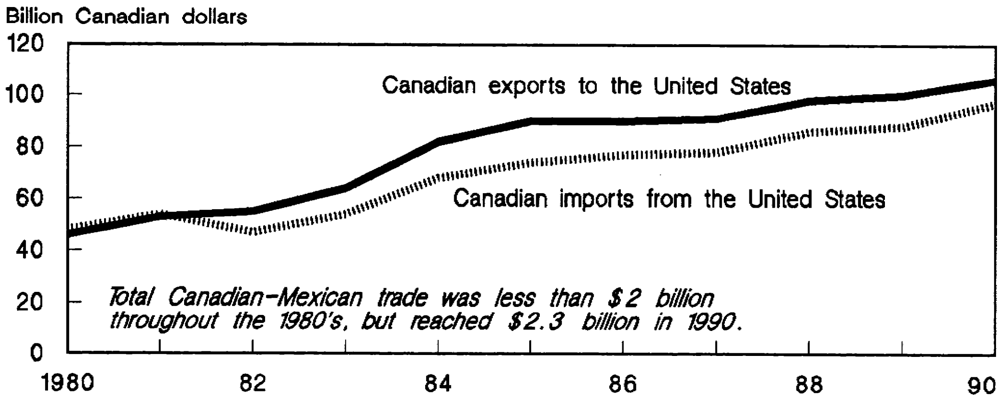
U.S.-Canadian trade flows reached nearly Can$205 billion in 1990, more than three times the level of U.S.-Mexican bilateral trade. Two-way trade between Canada and Mexico for all products was Can$2.3 billion in 1990 (fig. 1). Agricultural trade between the United States and Canada has continued to expand since the CFTA, as it has for a decade.

As with the CFTA, NAFTA negotiations concerning agriculture will be sensitive in part because the close link between domestic agricultural policies and trade barriers makes it difficult to disentangle the two. Relative to its northern neighbors, Mexico's lower income (U.S. and Canadian per capita income is 10 times that of Mexico) and dual agricultural sector (an export-oriented commercial sector and a domestic-oriented subsistence sector) raise issues that were not present in the CFTA negotiations.

Canadian agricultural trade with Mexico is small in comparison with its trade with the United States, and this would not significantly change under a NAFTA. However, some of the provisions of the CFTA--tariff reduction, a temporary tariff increase allowed on fresh fruits and vegetables in certain circumstances, and prohibitions on bilateral export subsidies--could provide guidelines for the drafting of a NAFTA.

Figure 1
Total Canadian trade with the United States and Mexico

Canadian trade with Mexico was tiny in comparison with Canadian-U.S. trade in the 1980's. Canada was a net exporter to the United States during the 1980's



The United States is Canada's Largest Agricultural Trading Partner

The United States provided nearly two-thirds of Canada's agricultural imports in 1990, and imported 37 percent of Canada's total agricultural exports.

Although a small producer relative to world output, Canada is a major agricultural exporter. Exports are dominated by wheat, but include livestock products, barley, canola (rapeseed), and potatoes. Crops provide about 60 percent of the value of all agricultural exports. Agricultural exports in the 1980's declined as a share of Canada's total exports, and agricultural imports grew faster than agricultural exports, eroding a trade surplus in agriculture.

The United States is Canada's largest supplier of agricultural imports. Fruits, vegetables, and other horticultural products account for about half of Canada's agricultural imports from the United States. In the mid-1980's, when Canada's dollar was weak relative to the U.S. dollar, Canadian importers looked to non-U.S. suppliers for horticultural products (for example, Chilean grapes and New Zealand apples). The U.S. share of Canada's agricultural imports remained constant at 55-60 percent throughout the 1980's, then jumped significantly in 1990.

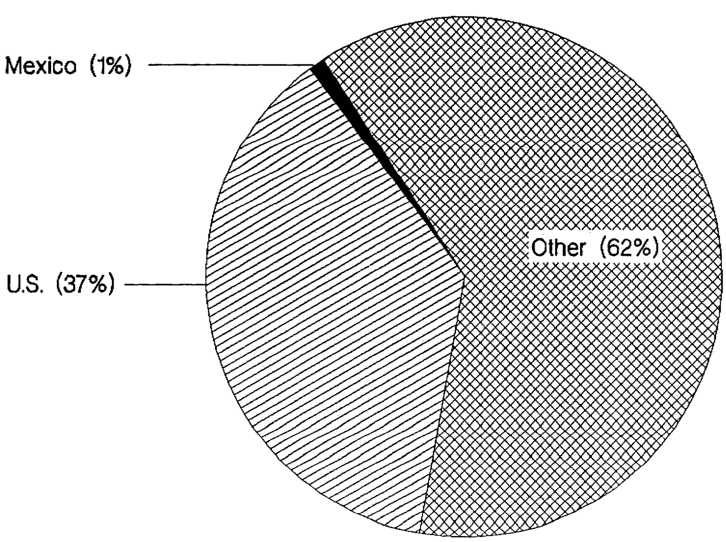
The United States has become an increasingly important market for Canadian agricultural exports, taking over a third of Canada's agricultural exports in 1990 (fig. 2). As Canada's crop exports were buffeted in the 1980's by low world prices and bad weather, its exports of animal products--mainly live cattle and hogs, pork, beef and other high-value products--increased relative to crops. Most of those animal product exports went to the United States.

Agricultural trade between Canada and Mexico is tiny compared with U.S.-Canadian agricultural trade (figs. 3 and 4). Canada's agricultural exports to Mexico were variable over the past decade, but agricultural imports from Mexico have risen steadily since 1984 (fig. 4). Canada ships mostly wheat, canola, and dairy products to Mexico, and imports products as diverse as cucumbers, cotton, coffee, and beer.

Figure 2
Canada's 1990 bilateral agricultural trade

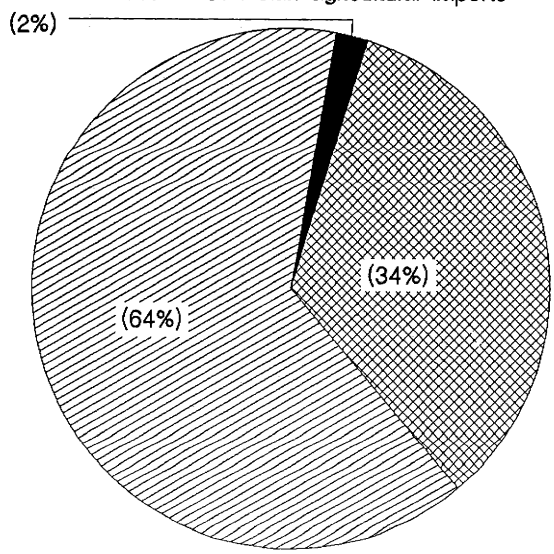
The U.S. role in Canadian agricultural trade is paramount, accounting for over one-third of Canadian exports and nearly two-thirds of Canadian imports.

Destinations of Canadian agricultural exports



(Can $10.1 billion)

Sources of Canadian agricultural imports

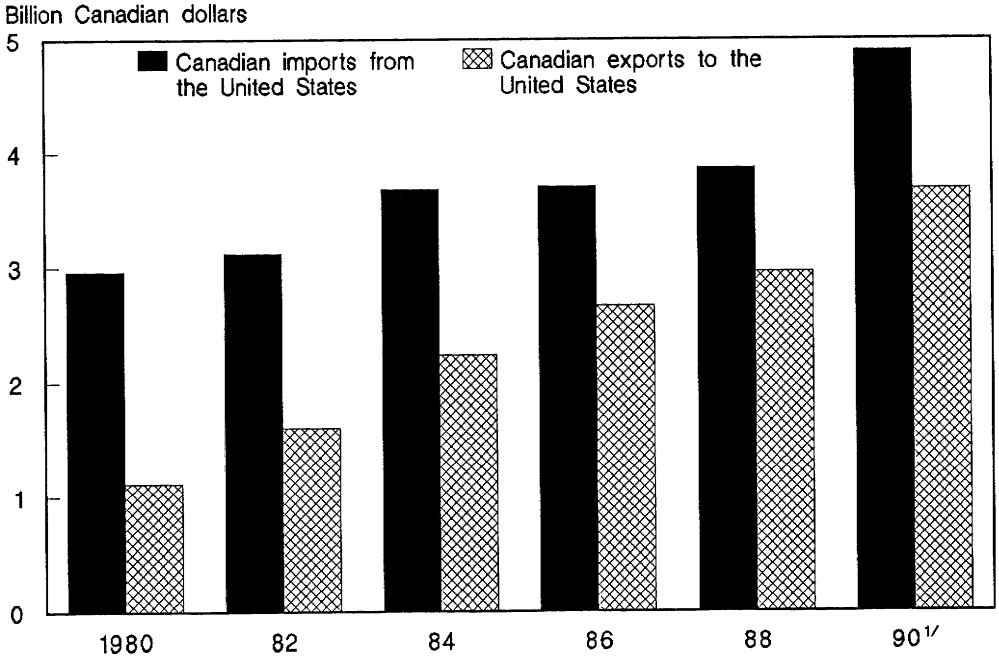


(Can $7.7 billion)

Figure 3

Canadian agricultural trade with the United States

Canadian exports to the United States have tripled during the past decade, while imports from the United States have risen by two-thirds.

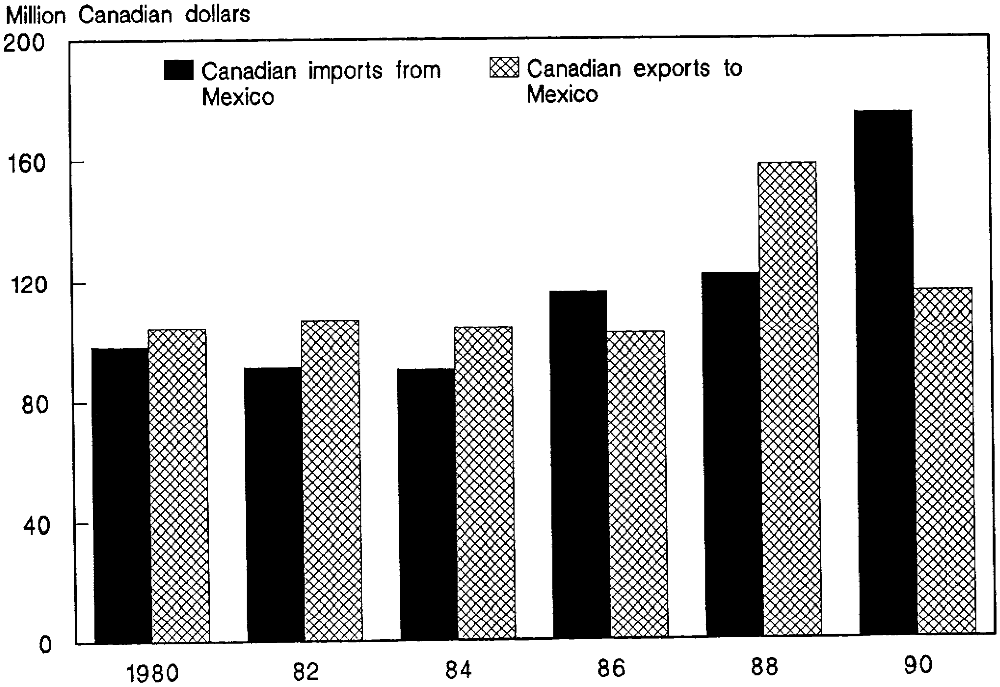


1/ Preliminary, estimated from U.S. export data.
Sources: Statistics Canada; U.S. Dept. Agr., FATUS, Economic Research Service.

Figure 4

Canadian agricultural trade with Mexico

Canadian imports from Mexico have risen during the past decade, while exports to Mexico have fluctuated.



Source: United Nations trade data, Statistics Canada.

Increased Canadian-Mexican Trade Means Some U.S. Products Will Face Stiffer Competition in the Mexican Market

Key commodities, such as wheat and canola, dominate Canadian-Mexican agricultural trade. Most of Canada's commodities exported to Mexico compete directly with U.S. commodities.

Canada competes with the United States in one part of Mexico's wheat import market, its market for feed-quality wheat. Canada's wheat exports to Mexico have been variable during the past decade, with no wheat exported to Mexico during 1984-85 and 1988-89 (fig. 5). Mexican import quantities are determined by Mexico's financial situation, the availability of credit, and Canada's supply of feed wheat, which can be substantial if rainfall is heavy at harvest. In 1990, Mexico signed a long-term grain agreement with Canada calling for an annual minimum of 75,000 metric tons of wheat to be imported from 1990 to 1992. The Canadian Wheat Board (see box on facing page) oversees those exports.

Another policy affecting Canada's competitiveness in world grain markets is the rail subsidy under Canada's Western Grain Transportation Act. The Federal Government annually provides about Can$720 million to the railroads for transportation of eligible grains and oilseeds from the prairie provinces to western ports and Thunder Bay, Ontario. The subsidy allows producers to pay below-market freight rates for products exported.

As with wheat, Mexican imports of canola have been variable (fig. 6). Canadian canola competes in Mexico with U.S. soybeans and oilseeds from elsewhere. Mexico purchases canola if the price is favorable. Quality and type (canola is a high-quality rapeseed) are less important than price. When Canada's supplies are competitively priced, they can be exported to Mexico, as in 1986-87. During 1989 and 1990 Canadian canola was displaced in the Mexican market by cheaper Polish rapeseed.

To encourage Mexico to buy canola, Canada has provided Mexico's crushing industry with technical assistance to process canola seed. Unlike wheat and barley, canola is traded by the private sector and priced on the Winnipeg Commodity Exchange. Other Canadian policies affecting canola, such as the transportation subsidies, are the same as for wheat.

Mexico was Canada's largest customer for dairy products in the 1980's. Exports reached $84 million in 1981 but dropped off in the mid-1980's as Canada reduced milk production and exports declined. Quantities available for export depend on surpluses generated by Canada's supply management system for dairy production. Milk producers receive high, guaranteed prices, with production and imports regulated by quotas.

Producer levies are used to subsidize exports of nonfat dry milk and other dairy products. Mexico takes a substantial, although variable, share of both U.S. and Canadian nonfat dry milk exports. Both countries sell nonfat dry milk to Mexico at prices much below U.S. and Canadian domestic wholesale prices, which reflect milk support prices.

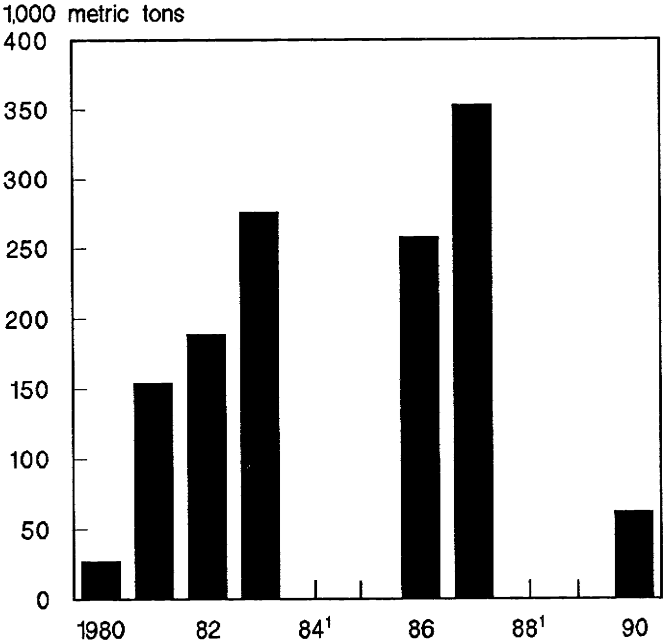
Fruits, vegetables, and other horticultural products account for less than 10 percent of Canadian farm cash receipts. The United States is the dominant supplier of Canada's horticultural imports, but imports from Mexico are increasing. Canadian fruit and vegetable imports from Mexico, including cucumbers, peppers, melons, and frozen strawberries, jumped sharply in 1990, led by a near tripling of tomato imports. In the 1980's, fruit and vegetable imports claimed a larger share of Canada's agricultural imports from Mexico, rising from 45 percent in 1980 to 76 percent in 1990.

Canada imposes seasonal tariffs on fruit and vegetable imports. These tariffs are 30 percent lower on U.S. products than on Mexican products as a result of the CFTA. Under the Canadian Agricultural Products Act, all imported produce must have a specified buyer and the imported goods may be restricted based on standards for size, quality, labeling, and packaging.

Figure 5

Canadian wheat exports to Mexico

Wheat exports to Mexico have varied during the past decade, but the 1990 Canadian/Mexican Grain Agreement should ensure Mexican imports through 1992.

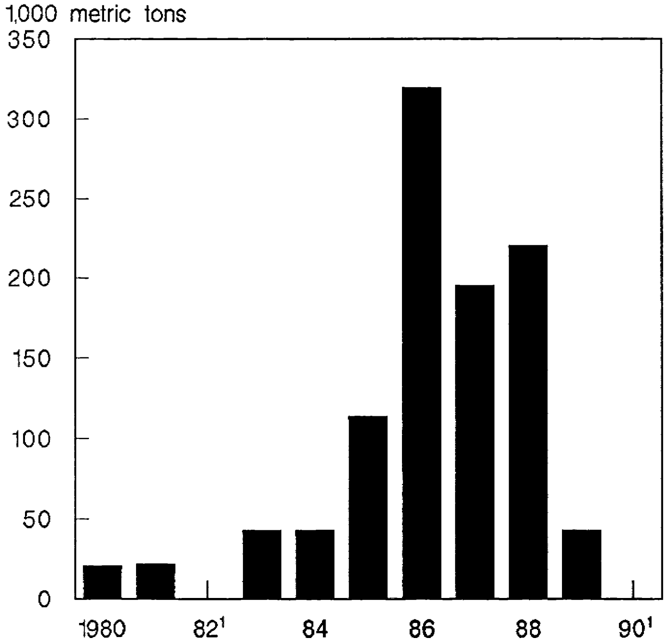


1/ Canada exported no wheat to Mexico during 1984-85 and 1988-89.
Source: Canadian Grain Commission. August-July marketing year.

Figure 6

Canadian canola exports to Mexico

Cheaper Polish rapeseed displaced Canadian canola in 1990, despite Canadian assistance to Mexico's crushing industry.



1/ Canada exported no canola to Mexico during 1982 and 1990.
Source: Canadian Grain Commission. August-July marketing year.

The Canadian Wheat Board

The Canadian Wheat Board (CWB) is Canada's sole legal exporter of western-grown wheat and barley (and oats, until 1989). Canadian wheat exports to Mexico in the 1986/87 and 1987/88 marketing years were made under CWB credit. Under these arrangements, the CWB borrows from the commercial banking system at one-quarter percentage point below the prime rate. Credit is extended for 3 years and is backed by Canada's Federal Government.

Before the CFTA, U.S. wheat, barley, and oats imports into Canada were permitted only under special licenses, which were rarely issued. This policy permitted the CWB to maintain a two-price system for wheat, whereby domestic wheat prices were higher than export prices. Under the CFTA, import licenses were removed on U.S. oats and wheat and products.

CFTA Will Phase Out All Agricultural Product Tariffs by 1998

The CFTA liberalizes agricultural trade chiefly by removing tariffs, although other trade restrictions have also been reduced or removed.

The CFTA reduced or removed tariffs and mitigated the effects of certain nontariff barriers to trade between the United States and Canada. Tariffs will be phased out such that all agricultural products will be duty free by January 1, 1998 (see page 10 for a summary of selected CFTA provisions). Each country also agreed to work toward elimination of technical regulations that arbitrarily restrain agricultural, food, and beverage trade (see box, Article 708).

A special provision for fruits and vegetables, known as the "snapback," guards against imports from either country depressing domestic prices. Either country may use the snapback provision, effective for 20 years from January 1, 1989, to reimpose temporary tariffs on fresh fruits and vegetables imported from the other country. The provision, however, can be used only once per 12-month period and only if two conditions prevail. First, the import price of the fruit or vegetable must be below 90 percent of a 5-year average monthly import price (excluding the highest and lowest years) for 5 consecutive days. Second, the planted acreage in the importing country for the fruit or vegetable must be no higher than the average area for the preceding 5 years, excluding the highest and lowest years.

The snapback duty is immediately removed as soon as the import price exceeds 90 percent of the benchmark price for a period of 5 days, or after a maximum of 180 days. The provision has been used three times through September 1991, all by Canada on U.S. imports.

The CFTA liberalized some nontariff barriers affecting grain, chicken, turkey, eggs, red meat, and sugar. Canada agreed to remove import licenses for wheat, barley, and oats and their respective products when U.S. support levels for these commodities are less than or equal to those of Canada. Canada also raised its global import quotas on chicken, turkey, and eggs to reflect actual imports over the 5 years previous to the agreement. The United States agreed not to restrict any Canadian product containing 10 percent or less sugar, by dry weight.

Each country agreed to exempt the other from its meat import laws, but can still take measures to avoid displacement should either country apply its meat import laws to other countries. For example, if the United States limited beef imports from Australia but Canada did not, then Australia could freely ship beef to Canada. In turn, Canada could ship the same amount of its beef to the United States. The effect on the U.S. beef industry is the same as if Australia had shipped its beef directly to the United States. Under such circumstances, the United States may impose quantitative restrictions on imports from Canada to prevent such displacement.

The CFTA contained few provisions addressing subsidy practices. The only subsidy specifically prohibited in the CFTA is Canada's rail subsidy under its Western Grain Transportation Act on grain and oilseed exports shipped to the United States through Canadian west coast ports.

The United States and Canada further agreed not to introduce or maintain any export subsidy on agricultural products shipped to the other country, making the CFTA the first international agreement to forbid export subsidies in bilateral trade.

The CFTA's Article 708: Removing trade barriers

To develop technical regulations that will facilitate an "open" Canadian-U.S. border, eight working groups will seek to remove existing barriers to trade, to prevent new barriers, and to harmonize technical standards, recognizing international standards.

The eight groups are:

- Animal health
- Plant health, seeds, and fertilizer
- Meat and poultry inspection
- Dairy, fruit, vegetable, and egg inspection
- Veterinary drugs and feeds
- Food additives and unavoidable contaminants
- Pesticides
- Packaging and labeling

Agricultural Trade Expands Under the CFTA

U.S.-Canadian agricultural trade rose in the first 2 years of the CFTA as tariffs were reduced, poultry quotas were enlarged, and Canadian import licenses on U.S. oats and wheat were removed.

U.S.-Canadian agricultural trade expanded following implementation of the CFTA. During 1989 and 1990, U.S. agricultural exports to Canada grew at a higher rate than its agricultural exports to other countries (table 1). For some of the leading agricultural products traded between the United States and Canada, trade has increased dramatically during the 2 full years that the CFTA has been in effect (fig. 7).

The 1988 North American drought strongly affected trade in 1989. Because of the drought, Canada's total agricultural exports declined, even as its exports to the United States rose. Although it is not possible to attribute the growth in bilateral trade solely to the CFTA, some of the provisions could be expected to boost trade between the two countries. These include tariff reductions, larger import quotas on poultry, and removal of Canada's import licenses on grains.

Tariffs on agricultural goods, already low for most commodities, have fallen by at least 30 percent. For some agricultural products, tariffs have declined by 60 percent or have been completely removed.

Canada removed its import license requirements on U.S. oats and products in 1989 and on U.S. wheat and products in 1991. In anticipation of the removal of the wheat import license, the Canadian Wheat Board changed the two-price wheat system so that domestic wheat prices would more closely follow U.S. prices.

Poultry imports, especially chicken, have increased with the expansion of import quotas under the CFTA. The chicken import quota rose from 6.3 to 7.5 percent of the previous year's production, while the turkey import quota rose from 2 to 3.5 percent of the current year's production. The shell egg import quota rose from 0.68 to 1.65 percent of the previous year's production. Supplementary imports are permitted above the global quota. Canada's production quotas restrict producers' response to increased demand and higher prices.

Table 1--Percent change in agricultural trade

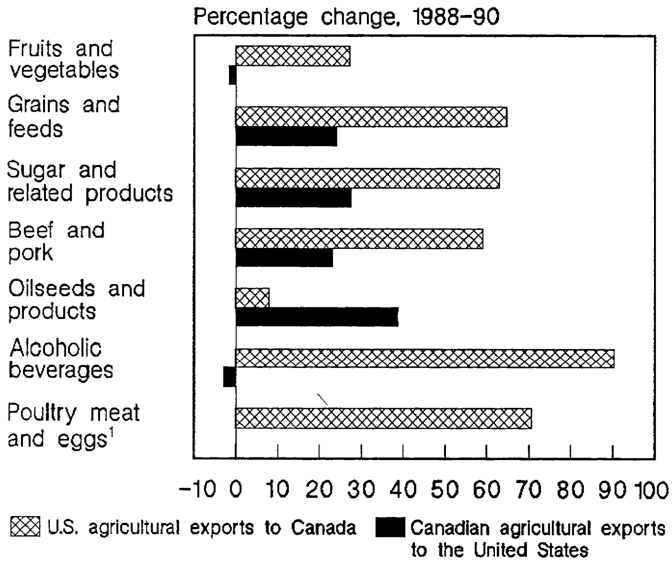
U.S.-Canadian agricultural trade continued to increase during 1988-90. The 1988 North American drought sharply influenced each country's trade from 1988 to 1989.

Year	U.S. agricultural exports		Canadian agricultural exports	
	To Canada	To rest of world, excluding Canada	To United States	To rest of world, excluding the United States
	Year-to year percent change			
1988-89	12	8	19	-25
1989-90	17	-7	8	21

Figure 7

The CFTA expanded U.S.-Canadian agricultural trade

Agricultural exports between the two countries have shown strong growth for most commodities since passage of the CFTA.



1/ Canada exports only small quantities of poultry products to the United States.

Bilateral Trade Disputes Continue Despite the CFTA

Trade complaints continue despite easing of some trade barriers. Rulings on both sides of the border could set precedents for future actions.

Although some trade barriers have been eased, trade disputes continue. The most notable agricultural dispute occurred in September 1989 when the United States imposed a countervailing duty on Canadian pork. A country can impose additional duties on imports from another country to offset illegal subsidies that harm a domestic industry. The U.S. Government determined that the U.S. pork industry was threatened with material injury by subsidized pork imports from Canada.

A binational CFTA panel reviewed the U.S. Government's decision and questioned the determination of material injury. The United States then appealed the case to an extraordinary challenge committee. This was the first time such a committee was used in the CFTA. The committee ruled in Canada's favor and the United States agreed to remove the countervailing duty.

To eliminate port-of-entry inspections in both countries, Canada and the United States agreed in February 1990 to a 1-year open border experiment for meat and poultry under the auspices of CFTA Article 708. The experiment would have recognized Canadian meat inspection as equivalent to the U.S. standard. However, implementation of the proposal was delayed. The experiment was finally withdrawn in October 1991. During the delay, Canada began re-inspecting U.S. meat imports.

A combination of market conditions since 1987 (reduced U.S. domestic supplies due to drought, lower U.S. quality due to weather and certain grading practices, and U.S. domestic prices above world export prices) have led to significant U.S. imports of Canadian durum wheat (fig. 8). U.S. durum producers claimed the Western Grain Transportation Act (WGTA), acting as an export subsidy, was the main cause. CFTA Article 701 forbids bilateral export subsidies.

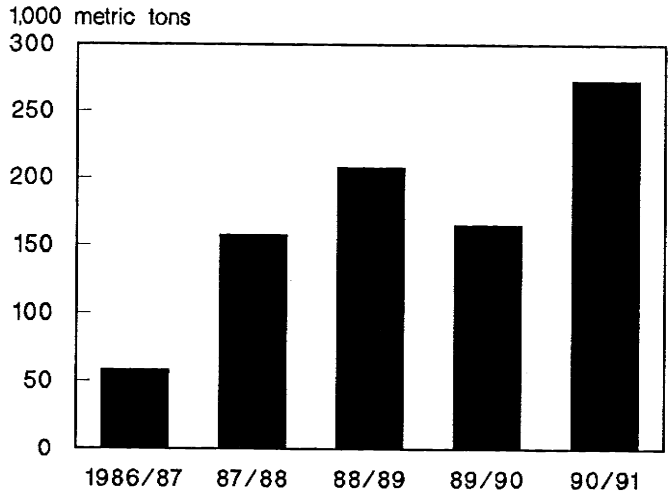
The WGTA subsidy was eliminated on westbound shipments to the United States. All eastbound shipments to Thunder Bay, Ontario, whether destined for export or Canada's domestic market, receive the WGTA subsidy. Thus, the WGTA is not considered a bilateral export subsidy under the CFTA.

U.S. durum producers have also complained that the Canadian Wheat Board has sold wheat to the United States at prices that violate Article 701 (see CFTA provisions, page 10), which prohibits public entities from exporting goods below their acquisition price. But monitoring this article with respect to CWB wheat sales to the United States is difficult because the CWB does not publish sales prices.

The U.S. Export Enhancement Program (EEP) has been a target of Canadian criticism. One of EEP's objectives is to improve U.S. competitiveness in agricultural trade by offsetting subsidies and "other unfair trading practices" of competitors, primarily the European Community (EC). The United States has used export subsidies in markets such as Algeria, Brazil, and the Philippines, where Canada has also been an active exporter. The Canadian Government has asserted that EEP activities in these markets are a possible violation of Article 701, and has claimed that the United States failed to consider Canada's export interests when using an export subsidy on shipments to other countries.

Figure 8
Canadian durum wheat exports to the United States

Canadian exports of durum wheat to the United States have risen steadily during the past 5 years, due both to the 1988 North American drought and favorable U.S. prices.



Source: Canadian Grain Commission. June-May marketing year.

Implications of a North American Free Trade Agreement for Canada and the CFTA

Canadian products that are competitively priced, like wheat and livestock, would likely benefit from improved access to Mexican markets. An influx, under NAFTA, of lower priced imports, like horticultural products, could reduce prices and force some Canadian producers out of business.

If Mexico lowers its trade barriers, Canadian exports of grains, oilseeds, meats, and other livestock products would likely benefit. In the past few years, for example, Canadian canola exports to Mexico have been displaced by cheaper Polish rapeseed. A NAFTA could assist Canadian exports if it gave preferential access to North American products.

If Canada lowered its trade barriers, its horticultural sector, already under pressure from imports, could face even more imports. Canada's consumers would benefit from a wider choice of affordable produce, but its growers fear that more imports would lower product prices to a point where their businesses could no longer compete.

The CFTA can be seen as a starting point for the NAFTA, though many of the CFTA's provisions will have to mesh with the new North American accord. For example, the tariff reduction schedule in the CFTA will not be changed, but Canada and Mexico will adjust their tariffs relative to each other. The tariff snapback for fresh fruits and vegetables is easing Canada's adjustment to a tariff-free border in the CFTA; some U.S. producers also want snapback protection against Mexican products. The CFTA provided a forum for harmonizing technical regulations between U.S. and Canadian agricultural industries. The reconciliation of different standards in agricultural production and food safety is further complicated by the addition of a third country--Mexico.

Agricultural subsidies were left basically untouched in the CFTA, although the agreement did remove the transportation subsidy on Canadian exports to the United States through west coast ports. Most Canadian wheat and canola exports to Mexico are shipped through these same ports.

The CFTA bans the use of export subsidies in bilateral agricultural trade. Extension of this ban to a NAFTA would hamper some U.S. and Canadian exports, especially if other countries continued to use export subsidies in Mexico. EEP sales accounted for most U.S. wheat exports to Mexico in the late 1980's. Both the United States and Canada compete in Mexico's dairy market with subsidies. Both countries have used government-guaranteed credits not considered as export subsidies in exporting grains and oilseeds to Mexico.

When two countries compete in a third country, a reduction in barriers will affect the balance of trade:

(1) U.S.-Canadian competition in Mexico. Canada will want to achieve equal access with the United States for exports to Mexico (wheat, oilseeds, vegetable oils, and animal, dairy and forest products).

(2) Mexican competition in the United States and Canada. If the United States increases imports (fresh vegetables) from Mexico, will it export a like amount to Canada? Any additional U.S. exports to Canada could further pressure Canadian horticultural producers.

(3) Mexican-Canadian competition in the United States. The United States imports live cattle and beer from both Canada and Mexico. Mexican exports of processed food products to the United States could outsell similar Canadian exports to the United States, because of Mexico's cheaper labor and reduced tariffs.

CFTA Provisions Affecting Agriculture

Article 401: Tariffs on all agricultural goods will be removed over 10 years. Agricultural products that were duty-free before the imposition of the CFTA will continue to be so. Most agricultural products fall under category C (see below). However, a provision (401.5) permits accelerated elimination of tariffs, provided both governments agree. The phase-out categories in which products are placed are:

A: Immediate tariff elimination, effective January 1, 1989;
B: 5-year tariff elimination in five equal annual stages, duty-free on January 1, 1993;
C: 10-year tariff elimination in 10 equal annual stages, duty-free on January 1, 1998.

Article 701: Public organizations cannot export agricultural goods to the other country at a price below the acquisition price, plus storage and handling costs. Neither country can use export subsidies in bilateral trade and each will consider the other when using export subsidies to other countries. Canadian goods (eligible grains and oilseeds) shipped to the United States through west coast ports are excluded from receiving transport subsidies.

Article 702: Tariffs on fresh fruits and vegetables can snap back to the tariff that was in effect at the time the agreement was signed if certain price and acreage restrictions are met.

Article 703: Both countries shall work toward improving market access by removing trade barriers.

Article 704: Each country excludes the other from its meat import law.

Article 705: Canada will remove its import license on wheat, barley, and oats when U.S. Government support levels for those grains are equal to or less than Canadian Government support. Annex 705.4 contains the support methodology.

Article 706: Canada enlarged its global import quotas for chicken, turkey, and shell eggs.

Article 707: The United States will not restrict Canadian imports of products containing 10 percent or less sugar.

Article 708: The United States and Canada will work toward harmonizing their technical regulations and standards.

Chapter 8: This chapter reduced trade barriers in wine and distilled spirits arising from measures related to their internal sale and distribution.

Chapter 19: Binational dispute settlement panels will rule on cases involving countervailing and antidumping duties.

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