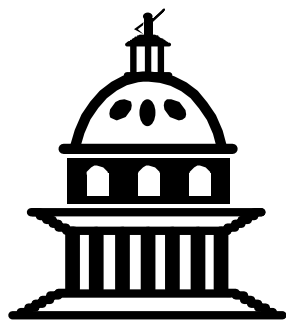


**U.S.-CANADA AGRICULTURAL POLICY HARMONIZATION:
POTENTIAL POLICY CHANGES AND THEIR CONSEQUENCES**

AFPC Policy Issues Paper 97-2

July 1997



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U.S.-CANADA AGRICULTURAL POLICY HARMONIZATION: POTENTIAL POLICY CHANGES AND THEIR CONSEQUENCES

Ronald D. Knutson

Has the Canadian-U.S. Free Trade Agreement (CUSTA) been a success or a failure? What is the potential for policy changes in the future? Who will win and who will lose? One of the central issues involves whether NAFTA has been a positive factor in trade, jobs and economic growth. In the United States, this issue is being fostered by debate over the extension of fast-track authority for further negotiation of trade agreements. Before fast-track authority is extended, it is suggested that there is a need to know more about the economic impacts of NAFTA, CUSTA and the Canadian-Mexican Trade Agreement. With Mexico, the center of the U.S. concern revolves more around nonagricultural trade, although fruit, vegetable, and beef cattle imports from Mexico have become a lightning rod. However, recently, U.S. wheat imports from Canada have become an issue in the extension of fast-track authority.

The success of CUSTA in facilitating nonagricultural trade appears to be largely unchallenged. In agriculture, the issue is considerably more debatable. To an important extent, this is a result of the construction of CUSTA because it contained little that provides leverage for harmonization where there are basic differences in domestic policy such as dairy, poultry and sugar (Gifford). Interestingly, this has similarities to the record of experience under the multilateral trade negotiations (MTN) where the settlement of agriculture issues was negotiated separate from nonagriculture negotiations, and agriculture progress was very slow. In the Uruguay Round, however, the tables were turned as agriculture effectively held the nonagriculture sector agreement hostage until significant progress toward freer trade in agriculture was realized. Significant changes in domestic policy resulted in certain commodity areas, but others escaped.

This paper addresses the future potential for harmonization of agricultural policies between the United States and Canada and their consequences. It does this by first evaluating the forces leading to harmonization. It then develops a matrix of problem areas by commodity and by country where trade barriers appear to be problematic.

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Many of the ideas for this paper result from the three Canada-U.S. Trade Disputes Workshops which evolved from concern that economists do not always come to the same conclusions regarding the impacts of either trade or domestic policy change. The workshops are designed to discuss, understand and evaluate the basis for these differences. Moreover, from policy changes such as the elimination of Canada's Western Grain Transportation Act (CWGTA) subsidy, it is clear that few, if any, economists fully understood the complexity of consequences in terms of rearranging pricing patterns, comparative advantages, and production patterns for livestock (Wilson and Johnson, Kirk).

Forces Leading to Harmonization

As implied previously, one of the weaknesses of the NAFTA-CUSTA system of trade agreements is the lack of an effective dispute settlement mechanism for moving the three countries progressively in the direction of freer trade. However, for both Canada and the United States, forces continuously operate that have the effect of slowly but progressively pushing policy in the direction of greater harmonization, including:

- Budget pressures.
- The Uruguay Round Agreement including the important World Trade Organization (WTO) mechanism.
- The fragmentation of commodity pressure groups.

All three of these forces are sufficiently important to warrant comment.

Budget Pressure

A principal force affecting both U.S. and Canadian agricultural policy has been pressure to reduce spending in the aggregate. While at one time agricultural subsidies might have been viewed as entitlements, this is no longer the case. Moreover, the perspective that U.S. entitlements are untouchable may have changed, or be changing, with the balanced budget agreement. In the 1996 Farm Bill debate, Chairman Roberts of the House Agriculture Committee felt sufficiently insecure about the impacts of budget pressures on farm program spending that he provided for seven year contracts between farmers and the government to ensure payment of the

fixed transition payments. Since the 1985 Farm Bill, budget pressures have played a major role in decisions to impose set-aside requirements, freeze target prices and reduce milk price supports.

In Canada, Hedley and Gellner indicate that governments at both the federal and provincial levels have faced severe budget pressures over the past several years. They attribute budget pressures, at least in part, to the elimination of the WGTA subsidy, elimination of the Feed Freight Assistance subsidy, a 30 percent reduction in federal safety net spending over three years, and a 30 percent reduction in dairy subsidies. In contrast with the United States, there are indications that significant improvements in both Federal and Provincial debt control could reduce the relative importance of budget pressure in future Canadian policy.

In summary, for both the United States and Canada, farm subsidies have taken on more of the characteristics of discretionary spending than of entitlements.

Uruguay Round/WTO

For both the United States and Canada, it is often difficult to separate budget pressures from the multinational trade negotiations as factors influencing policy decisions. It is plausible that in both the United States and Canada there was high level executive policy agreement that trade negotiations could be utilized as a means of achieving both freer agricultural trade and reduced spending goals. Such speculation raises the interesting issue of who makes U.S. and Canadian trade policy.

Policymaking in the Canadian parliamentary system is quite different than the U.S. democracy. One of the basic characteristics of the parliamentary system is that the party of the majority is clearly in charge with the Prime Minister, who is the leader of the majority party, and his Cabinet Ministers being the origin of all legislation and major policy decisions (Hedley and Gellner). Of course, by definition of the parliamentary system, the Prime Minister also has a majority control of the legislative process. This degree of centralization of power would exist in the United States only when the party of the President also controls both Houses of Congress, which is seldom the case.

In both the United States and Canada, there is split jurisdiction within the executive branch between trade and agricultural policy. In the United States, that split is between the U.S. Trade

Representatives (USTR) office in the Executive Office of the President, the Secretary of Agriculture, the U.S. Treasury, the Department of State and the Department of Commerce. USTR generally has strong agricultural representation somewhere in its hierarchy. In Canada, the split is between the Department of Agriculture and Agri-Food (Ag Canada) and the Department of Foreign Affairs and International Trade.

The U.S. democracy is designed as a system of checks and balances between the legislative, executive and judicial branches. As a result, there has always been an issue of who determines trade policy. Arguably, since the President has control of the trade policy influencing departments (USTR, USDA, State, Treasury and Commerce), and since the President is traditionally thought to control foreign affairs, conventional wisdom suggests that the President should be in charge of trade policy. Such a conclusion regarding the policy process is far too simple. The Congress develops trade legislation in its own right, it confers fast-track authority to the President, and it votes to confirm trade agreements. As is seen in the current debate regarding the extension to the President of Western Hemisphere fast-track negotiating authority, Congress has a mind of its own on trade issues.

The third actor on trade issues is the special interest pressure groups. In agriculture, for both Canada and the United States, the strongest of these groups tends to have a commodity orientation and their very specific ideas of what trade policy should be.

An interesting study is in process at Texas A&M which concludes that U.S. trade policy decisions depend on the strength of the President relative to that of the Congress, the position of the bureaucracy, and the power of the special interest groups (Carter and Eden).

In the United States, the most powerful commodity groups in a position to demand protectionist policies have been sugar, peanuts, wheat and tobacco. In Canada, it has been dairy, poultry, wheat and barley.

It is important to point out that despite the commodity influences, a strong U.S. policy consensus has developed favoring freer trade in agriculture. This consensus developed in the 1970s with the development and passage of the Trade Reform Act of 1974, under the leadership of Presidents Nixon and Ford, Secretary of State Kissinger, and Secretary of Agriculture Butz. It is important to note that, while many setbacks can be cited, the momentum favoring freer trade

has become consistently stronger and has existed through both Democrat and Republican administrations.

Statistically, Canada should be more committed to free trade than the United States. Canadian exports in 1990 were 23 percent of its gross domestic product (GDP), while the United States exports 7 percent of its GDP. Agricultural exports in Canada were 67 percent of the value of agricultural production while the United States exported 42 percent of the value of agricultural production. From these data, one can readily conclude that Canada is more export-dependent than the United States. This suggests that there should be greater resolve in Canada toward the objectives of open markets and freer trade. Canada is a small open economy with annual population growth of about 1 percent. It has mature domestic market from an agriculture and food products perspective. Growth in the Canadian agriculture sector is clearly dependent on exports. The large size of the U.S. domestic market makes it less export dependent and a significant attraction to Canadian exporters. However, many aspects of U.S. agricultural markets also have characteristics of maturity with roughly the same rate of population growth as Canada.

Fragmentation and Decline of Commodity Pressure Groups

Historically, commodity groups have been the strongest agriculture special interests in both the United States and Canada. The potential elimination of U.S. farm subsidies (transition payments) in 2002 is evidence that the power of commodity groups has declined. Only sugar, peanuts and tobacco were able to maintain their basic program provisions in the 1996 Farm Bill. Cotton and rice maintained their marketing loan benefits but, like other major commodities (corn, wheat, sorghum and barley), lost their target price benefits.

These losses reflect a decline in the power position of commodity organizations. It may also reflect a philosophical shift away from subsidies toward freer trade. However, the potential elimination of subsidies raises questions regarding what functions U.S. commodity organizations will play in the future. Will farmers continue to support organizations that fail to “bring home the bacon” in terms of subsidies? Equally important, the absence of commodity organizations would raise questions concerning the future of USDA.

While the influence of farmer-oriented commodity organizations declines, that of agribusiness is increasing. The National Grain and Feed Association was a primary force supporting the Freedom-to-Farm decoupling provisions of the 1996 Farm Bill. The agribusiness mission has clearly become one of full production, freer trade and less public sector support for agriculture.

The decline in Canadian subsidies would suggest that similar commodity organization development is occurring there. Questions regarding the level of farmer support for the CWB is further evidence of fragmentation. In Canada, as in the United States, as subsidies are reduced, the nature of government policies toward agriculture has become dominated by issues of trade, value-added processing, regulation and macroeconomic policy. On these issues, producer concerns vary by size of farm, by commodity and by region. These differences create fragmentation within organizations and make it more difficult for national organizations to reach a consensus.

In both the United States and Canada, communication technology should not be overlooked as a force leading to fragmentation. With the Internet, larger more sophisticated producers are in a much better position to communicate directly with their organizations and with politicians. The result may not only be reduced perceived need for national organizations but less interest in them. National organizations will need to be much more astute to stay ahead of the game and thereby maintain a cohesive organization.

Conclusions on Pressures for Harmonization

One concludes that the pressures for harmonization are substantial. As subsidies decline, producers can only hope for higher incomes in the export market. The strongest pressure for harmonization will come from negotiations surrounding the WTO, not from NAFTA or CUSTA. In a sense, the pressure for change will come from outside agriculture, with strong support from the agribusiness sector within agriculture.

Barriers to and Consequences of Harmonization

Following the general approach of Barichello and Romain, the most complex problem areas where harmonization is required include the following:

- Domestic supply management.
- Import management.
- Export promotion/subsidy programs.
- State trading.
- Domestic subsidies.
- Sanitary and phytosanitary regulation.

Figure 1 is a matrix of the commodities that appear to be most directly affected by each of these problem areas and the country on which the problem is most clearly focused.

Figure 1. Matrix of Harmonization Problem Areas and Commodities Affected.

	Cotton	Dairy	Fruits and Vegetables	Grains	Livestock	Oilseeds	Poultry	Rice	Peanuts	Sugar	Tobacco
Domestic Supply Management		CA					CA		US		US
Import Supply Management	US	CA US	US	CA US	US		CA		US	US	
Export Promotion and Subsidies	US	CA US		US				US	US		
State Trading				CA							
Domestic Subsidies	US		CA US	CA US	CA	CA US		US	US	CA US	CA US
Sanitary and Phytosanitary ^{1/}		CA US	CA US	CA US	CA US	CA US	CA US				

^{1/}Arguably, all commodities could be affected in both Canada and the United States.

Domestic Supply Management

Supply management programs have not been a focal point of attention under WTO because a smaller quantity of price-suppressing commodities were put on the world market. Moreover, the Uruguay Round Agreement gave countries sufficient tariff rate quota flexibility to protect a limited number of markets having supply control provisions from imports. The commodities

affected for Canada are dairy and poultry while, for the United States, tobacco and, to a lesser extent, peanuts are affected.¹

Harmonization in these commodities involves eliminating the supply management component. Prices would then need to be set at a level that reflects supply-demand conditions which may, over time, mean that the world market price would be adjusted for time, space and form utility. Supply management distorts input allocations, reduces yields, results in geographic dislocations, and artificially builds asset values. For all of these reasons, producers fight to retain supply management programs.

Barichello and Romain estimate that for the Canadians, supply management programs generate \$0.41 cents in producer benefits for every \$1.00 of sales. In dairy, quota rents in Quebec are valued at \$10,000 in 1997, roughly 6.2 times the value of replacement cows (Knutson, Romain, Anderson and Richardson).

In the United States, Sumner indicates that the value of tobacco quotas average 25 percent of the price of tobacco and varies inversely with production costs. The value of the peanut quota is about equal to the price of peanuts sold in the domestic market. Both of these commodities have experienced declines in quota values because of the recognition that their future is threatened.

Supply management programs survive the Uruguay Round Agreement because these commodities have sufficient political muscle to secure Canadian over-quota tariffs in the range of 150 to 350 percent. While these provisions provide short-term protection, future trade negotiations make these commodities vulnerable to reduced protection.

The consequences of eliminating supply management programs are substantial. Quota asset values would be eliminated. Shifts in production locations are likely. For example, in Texas, the implementation of 1996 Farm Bill provisions allowing intrastate transfer of quotas is resulting in the movement of peanut quotas from Central and South Texas to the South Plains region of West Texas — a region which, in the past, produced only small quantities of peanuts, often

¹Peanuts utilize a two-price plan that establishes quotas for domestic market use at a relatively high price support. Peanut producers are allowed to contract for export sales at whatever price they negotiate.

competitively priced on the world market without quota. Similar geographic shifts among provinces have been suggested for dairy quota elimination in Canada (Barichello and Romain).

Import Supply Management

U.S. sugar policy is the best or worst example of import supply management, depending on one's perspective. U.S. sugar policy, like the E.U.'s variable levy, was developed based on its position as a net importer. Prices have been maintained at a level that is generally about 40 percent above world market equilibrium. U.S. sugar policy has provided an umbrella of protection for the development of the high fructose corn sweetener (HFCS) industry. This has resulted in a "sweet" political alignment between the corn producers and sugar producers in support of high sugar price supports and low import quotas.

If the sugar import quota was eliminated, sugar production in a number of production areas would decline dramatically. In all areas, land prices and rental rates would fall. HFCS would be less profitable. It is interesting to note that ADM, the largest HFCS manufacturer, withdrew from the agribusiness coalition that supported free market policies for the 1996 Farm Bill.

A feature of U.S. sugar policy that has been a Canadian irritant allows U.S. imports of raw sugar at world prices and its re-export in the form of sugar-containing products. This provision was designed as a protection to the U.S. sugar refiners and has become a means for their survival in the face of reduced sugar import quotas.

U.S. sugar policy has been under attack since the 1970s. It continues to survive by virtue of its alliance with corn. It enjoys the benefits of a favorable tariff rate quota which is legal under the Uruguay Round Agreement.

U.S. imports of beef meat are limited to 634,621 mt after which a 31 percent tariff rate quota is applied. Sumner estimates the price effect at only a few cents per pound. However, cattle interests consistently "beef" about imports of both fresh meat and live cattle from Mexico and Canada. Since cow-calf operators and feedlots have conflicting interests on the live cattle import issue, policies allowing free movement of live cattle across the U.S. border are likely to continue.

Both the United States and Canada maintain import restrictions on dairy products. Market-access levels approximate the minimum levels under the Uruguay Round Agreement — 3 to 5

percent. The Canadian restrictions are designed to protect the integrity of its supply management program, as is the case with poultry import restrictions. Initially, U.S. dairy import restrictions were designed to protect the integrity of its price support program. However, with the elimination of the price support program in 1999, dairy import restrictions and dairy export incentive subsidies (discussed subsequently) will be the only basis for supporting U.S. manufactured product prices. FAPRI analyses suggest that the U.S. dairy farmers would benefit from the combined elimination of export subsidies and increases in market access to 10 percent of domestic use. However, the combined effect of such a policy change is only a 1.4 percent increase in the U.S. all-milk price (Young and Brown).

U.S. policy has generally been to maintain open borders for imports of grain and oilseeds. However, with the advent of increased wheat imports from Canada, a 1.3 million bushel limit was placed on wheat imports from Canada in 1994/95. Despite its subsequent removal, this restriction remains as an important irritant to U.S.-Canadian trade relations as does Canadian licensing of imports of wheat, barley and oats (Meilke and Pursaga). The origin of these licensing provisions lies in different grading systems, resulting in the need for and use of certificates as a condition for exports from the United States. Reality suggests that these provisions may be more of an irritant and a political scapegoat than a real trade barrier.

Export Promotion and Subsidies

The most contentious U.S. export subsidy program is the Export Enhancement Program (EEP) and the DEIP. EEP was developed to expand exports of grains. Researchers have identified EEP as a major factor resulting in incentives for Canadian exports of wheat and barley to the United States (Young, Adams and Helmar). Their analysis suggests that, without EEP, beginning in crop year 1995/96, U.S. prices would have fallen by 9 percent, U.S. exports would have declined by 15 to 20 percent and Canadian exports would have risen by 14 percent. On the other hand, the world price as seen by the Canadians would have increased while the price incentives to market in the United States would have decreased.

Since 1995/96, the United States has exercised substantial restraint in the use of EEP. The U.S. Congress recently cut the EEP appropriation to half of the WTO cap and the Clinton

Administration's budget request. Yet there is still substantial incentive for Canadian exports of wheat and barley into the United States, in part because of the freer market pricing structure and the 1996 Farm Bill flexibility provisions allowing farmers to shift from wheat to corn, sorghum and soybean production. In the first quarter of 1997, U.S. wheat imports, mostly from Canada, doubled from the first quarter of 1996 to \$120 million.

Dairy export subsidies have been used by the United States to expand demand and reduce CCC stocks. The center of DEIP activity occurred during the early 1990s when U.S. milk prices were estimated to increase by \$0.30 to \$0.50 per cwt (Stillman, Blayney, Miller and Cranford). Of course, world prices declined with the increased volume of U.S. manufactured products on the market. In the mid-1990s, there was a hiatus in the use of DEIP with a restoration of a relative supply-demand balance for milk. However, in 1997, after a plummet in milk prices, DEIP subsidies were once again employed at the level of the WTO cap to bolster U.S. milk prices and to minimize CCC stock acquisitions.

Canada has utilized a combination of export subsidy programs to reduce dairy surpluses (Knutson, Romain, Anderson and Richardson). The major post-Uruguay Round program change involved the creation of a separate export class for milk with the costs shared among all producers. Some U.S. producer interests have advocated a similar program but USDA has concluded that this concept runs counter to the principles, if not the letter, of the WTO. For Canada, the elimination of its Class V export subsidy program would mean the need to either lower support levels to expand domestic demand or reduce quotas. For the United States, the absence of DEIP would mean lower domestic milk prices.

The other U.S. export subsidy program is the marketing loan program for rice and cotton. The marketing loan makes a loan deficiency payment to farmers when the world market price falls below the loan rate. While marketing loans are authorized for other major grains and oilseeds, cotton and rice are the only crops where the United States does not heavily influence the world market price.

There was a vigorous effort by the Clinton Administration and regional congressional interests to eliminate marketing loan authority in the 1996 Farm Bill. However, the price for Southern and Western support for the bill was the extension of this subsidy. Its elimination would

have jeopardized rice exports and, perhaps, the U.S. rice industry. For cotton, it would have reduced exports in large crop years, reduced prices and, therefore, reduced production.

State Trading

To the United States, state trading facilitates hidden/implicit export subsidies by virtue of the power vested in the state marketing agency to sell at a price that is below the world market price. The CWB acts as a state trader in wheat and barley in that farmers must market through the Board and its status as the exclusive exporter. Barichello and Romain do not see the CWB in this context. They recognize the Board as an institution that is designed to maximize producer returns from marketing, to equalize payments across producers through pooling and to equalize access to the grain delivery system.

Barichello and Romain recognize CWB issues relating to the exercise of monopoly powers and its potential contributions to inefficiency of grain handling. These issues have been raised most directly by Carter and Loyns (Carter). They contend that the Canadian grain handling system would be more efficient in the absence of the CWB. Farmers would also be in a position to seek the most profitable alternative markets for their grain.

What are the consequences of eliminating the CWB? The answer may be as complex as analyzing the impacts of eliminating the WGTA subsidy. Quite clearly, Canadian farmers having substantial marketing skill would be better off without the CWB. Whether U.S. farmers would be better off is subject to debate. The U.S. market for Canadian wheat and barley would likely become more attractive to Canadian producers, with the effect of reducing U.S. prices. As a result, with production flexibility under the 1996 Farm Bill, U.S. farmers could switch production patterns more in the direction of feed grains and oilseeds. Canadian farmers would concentrate on producing wheat, barley and canola where they appear to have a comparative advantage. It is also possible that the new found advantage of Prairie farmers in feeding cattle, raising hogs and milking cows could dissipate.

Domestic Subsidies

This category of programs is designed to cover various subsidy programs that apply generally to agriculture and have not already been discussed. These programs generally fall into three classes:

- Risk reduction/insurance.
- Environmental payments.
- Decoupled income subsidies.

They could represent the subsidy programs of the future for agriculture. While these programs are generally perceived to be decoupled in that they are unrelated to the quantity produced, if not well conceived and managed, they have the potential for distorting production patterns within and among countries. As noted in Figure 1, these programs cut across most of crop agriculture in Canada and the United States. In Canada, they have also made substantial inroads to animal agriculture.

Risk Reduction/Insurance

Both the United States and Canada have a long history of experience with crop insurance and disaster payments. This experience can best be classified as being spotty with substantial government outlays. The U.S. crop insurance program pays about 30 percent of the costs, but still, deficits in insurance accounts are not unusual. In Canada, producers pay only 25 percent of the costs. In the United States, premium structures are frequently criticized for being actuarially unsound and attracting the highest risk producers in the highest risk crops and areas of production (Lemieux, Richardson and Nixon).

In the absence of price/income support programs, interest has shifted to revenue insurance programs. Canada has more experience in this arena than the United States. Canada's Gross Revenue Insurance Program (GRIP) was designed as an income stabilization sequel to the WGTA subsidy (Barichello and Romain). Payments under the program were triggered when market revenues fell short of target revenues. Target revenues considered historical yields and a 15-year moving average price. Producers paid only one-third of the costs, which resulted in substantial

government outlays. However, on crop insurance, producers pay about 50 percent of the cost, although this varies among provinces.

The GRIP program has been terminated. Its successor is NISA, a program based on individual farmer stabilization accounts, to which producers and government contribute. Withdrawals are triggered by net income declines for individual farms. There are conflicting views within Canada over whether NISA is a green policy under WTO.

The danger with both crop and revenue insurance is that they become a substitute for subsidy programs of the past, they foster the production of the highest risk crops, and they can be exploited by producers (moral hazard). An additional danger, from a U.S. perspective, is that these programs become the captive of private insurance companies/agents who reap benefits that exceed provider costs (U.S. GAO). The subsidy issue has been a principle concern of Chairman Lugar of the Senate Agriculture Committee and, likely, of budget policymakers in the Clinton Administration.

Environmental Payments

Green payments have a green light under WTO. However, like revenue insurance, they have the potential for becoming a shelter for subsidies. It is the author's perception that the United States has more experience with green payments than Canada (Barichello and Romain, and Lindsey and Bohman). However, as regulatory demands increase, Canadians can be expected to give the issue of green payments more attention.

The largest of the green U.S. programs is the Conservation Reserve Program (CRP). Absent the requirement that the land be highly erodible, CRP would be classified as a production control program that applies to all crops. At its peak, CRP enrolled about 38 million acres or about 10 percent of U.S. cropland. The 1996 Farm Bill extended CRP while more specifically targeting its environmental benefits toward issues of water quality. This has been a politically charged issue because of its potential for eliminating from eligibility substantial lands west of the Mississippi River that are subject to wind erosion.

There has also been substantial concern expressed by agribusiness feed and export interests that the CRP program is too large and makes U.S. farm products less competitive in export

markets. While constraints on program size remain at 40 million acres, budget pressures are likely to result in a CRP program that is more in the range of 20 million acres.

The other major U.S. green payment program is the new Environmental Quality Incentive Program (EQIP). While this program is largely a consolidation of a wide range of soil conservation practice programs, which have counterparts in Canada, it has an important new thrust of attempting to curb animal waste pollution. Its effectiveness in materially reducing animal waste will be hampered by a structure-motivated \$50,000 payment limit and no subsidies to large production operations (over 1,000 animal units).

The EQIP program is currently too small (\$200 million annually) to have significant production impacts. However, there are those who would use the \$4 billion that will be on the budget table for debate in 2002 for EQIP-type green payments. If sufficiently targeted, a program of this magnitude could distort production patterns in a manner that runs counter to WTO policies.

Decoupled Income Subsidies

Several of the previously discussed programs in this section on domestic subsidies are arguably decoupled in that payments are not made per unit of output. However, the specific topic for discussion here is the lump-sum transition payments authorized by the 1996 Farm Bill. The crucial element in these payments, which are as large as historical direct subsidies to U.S. crop farmers, is that farmers have flexibility to produce virtually whatever crop they desire, except fruits and vegetables, and they can produce nothing if it is their wish. It is the maintenance of the latter provision — the flexibility to produce nothing — that is crucial to not distorting production patterns and trading relationships. Rice producers tried, unsuccessfully, to convince USDA and the Congress that continued crop production should be a requirement for transition payments.

Sanitary and Phytosanitary Barriers

Contemporary controversy suggests that technical barriers to trade may be the focal point of attention for future trade barriers. As a result, the third Canada/U.S. Disputes Workshop concentrated on this area. The problems identified fall into two general areas:

- Biotechnology.
- Food safety.

Theoretically, all commodities are affected by these issues. However, this discussion will be limited to dairy, fruits, vegetables, livestock, grains and oilseeds to give a sense of the nature of the evolving issues. Questions largely evolve around the notion of science-based determinations and the latitude countries will be given to interpret science.

Biotechnology

The relatively new era of biotechnology has already presented many phytosanitary issues. The only issue directly affecting the United States and Canada involves rBST, a synthetic milk production-stimulating hormone. However, many other biotechnological issues involving, for example, genetically engineered pest-resistant crops, concern other countries.

The rBST issue involves U.S. approval of the use of this hormone and Canada's lack of approval. Absent other restrictions on the flow of dairy products, the rBST policy difference could result in a major trade dispute.

One of the very significant issues raised by biotechnology involves consumers' right to know, regardless of the science-based determinations, and the feasibility of product segregation. Both of these issues have the potential for substantially increasing the cost of marketing and the level of government supervision of production processes. A marketing person would perhaps argue that biotechnology and product segregation offer an opportunity for adding value to farm products. At the same time, serious trade barriers could easily develop, making biotechnology policy a priority topic for the next round of trade negotiations.

Food Safety

The safety of the food supply has been a focal point of justified barriers to trade and of sanitary and phytosanitary controversy (Bredahl and Holleran). The example used here is the evolving issue of Hazard Analysis Critical Control Point (HACCP) application to livestock and poultry inspection. These procedures were put in place to control increasing incidences of virulent bacterial contamination of meat and poultry.

Because of the importance of trade in livestock, HACCP regulations, including bacterial contamination standards and testing procedures, need to be harmonized (Bredahl and Holleran). The future potential for HACCP conflict is even greater as requirements for tracing the origin of bacterial contamination to farms and ranches become increasingly stringent. In addition, differences in the application of HACCP to livestock and poultry hold the potential for U.S.-Canadian conflict in the longer run.

Conclusion

The central problem with CUSTA/NAFTA is that there was an agreement to leave major domestic farm programs in both countries intact. Any changes in policy-liberalizing trade that have occurred in either country were more in response to budget pressures and the outcome of the Uruguay Round Agreement than to CUSTA/NAFTA. This reality is likely to continue in the future.

The central bilateral trade conflicts relate to the Canadian supply management programs on dairy and poultry, CWB state trading status on wheat and barley, EEP and the U.S. import quotas on sugar. Substantial changes in WTO policies will be required in the next round of trade negotiations to effectively deal with these issues. The fact that similar policies exist in the European Union, Australia, New Zealand and Japan will make negotiations difficult. Moreover, U.S. priorities could focus on sanitary and phytosanitary concerns and obtaining other E.U. concessions. However, further raising of the market access requirements could be a key to progress on several fronts. In any event, two rounds of negotiations — at least 10 years — may be required for significant progress toward freer trade on these complex issues.

Two factors running contrary to this less than optimistic perspective are:

- The crumbling power of the agricultural lobby compared with the free trade lobby suggests that there may be a point at which CUSTA issues could be renegotiated — perhaps with the establishment of a broader Western Hemisphere agreement.
- There is evidence that, on supply management commodities, the gap between the United States and Canada may be widening. This widening gap puts more pressure on Canada and will require even greater adjustment once the forces of freer trade predominate. The

reality that a divergence rather than a convergence is occurring could lead to a Canadian reassessment of its trade and domestic policy position.

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