WESTERN AGRICULTURAL ECONOMICS ASSOCIATION

PAPERS OF THE
1989 ANNUAL MEETING

WESTERN AGRICULTURAL
ECONOMICS ASSOCIATION

COEUR D'ALENE, IDAHO

JULY 9-12, 1989

SESSION 4

The FTA After Ratification: Background and Prospects From a U.S. Perspective

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Introduction

The increasing U.S. trade deficit with Canada--and the declining U.S. surplus in agricultural products--in the 1980's set the stage for numerous trade disputes. Despite its small share of total trade, many of these disputes centered on agriculture--hogs, potatoes, yellow onions, wine, sugar and sugar blends, red raspberries, cut flowers, millfeeds, and corn. Use of domestic trade remedy laws, such as countervailing duty and antidumping laws, to reduce or restrict imports became a major source of disagreement and was a main focus of the 1986-87 bilateral trade talks.

From the persperctive of U.S. agriculture, many analysts look at the US-Canadian Free Trade Agreement and question its significance for agriculture. Yet, to evaluate the agreement, we need to put it into proper context. Concurrent negotiations on a multilateral agreement to reduce trade barriers under the auspices of the General Agreement on Tariffs and Trade (GATT)--particularly with its emphasis on agriculture--has overshadowed the FTA. The potential for major reforms in world agricultural trade being discussed in the GATT make the FTA look insignificant in comparison. This comparison is inappropriate for ?? reasons.

First, the commodity structure of production and trade for both countries is very similar. Table 1 shows that both countries derive the largest share of their total cash receipts from production of beef, dairy products and hogs. Wheat is far more important to Canadian aagriculture than it is to U.S. agriculture. The United States has a much more diversified crop sector than does Canada. Nevertheless, the similar commodity structures of the two countries' agricultural sectors mean that there is less scope negotiating changes that will have significant effects.

The similarities in production patterns are reflected in broadly similar commodity trade patterns. Tables 2 and 3 show the 1987 value of agricultural imports and exports for the United States and Canada, respectively. For both countries, more than 50 percent of the value of their total agricultural exports comes from grains and oilseed crops although Canada's exports are primarily wheat and U.S. exports are spread among wheat, feed grains, and oilseeds. More of the major differences begin to appear on the import side. Both countries import significant percentage of tropical agricultural products as indicated by the size of the "Other" category. But the major area of complementarity appears to be trade in fruits and nuts. Almost a quarter of Canadian agricultural imports are fruits and nuts. (The U.S. proportion is nearly 14 percent but much of this is imports of bananas.)

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[1] Invited Paper for presentation at the 1989 Annual Meetings of the Western Agricultural Economics Meetings, July 10-13, 1989. The views expressed in this paper are those of the authors and do not necessarily reflect those of the U.S. Department of Agriculture.

The second reason that we cannot expect as much of a bilateral U.S.-Canadian accord on agriculture as could be achieved in a multilateral context is that barriers to agricultural trade are primarily nontariff measures which are inextricably linked to domestic agricultural policies. A signifiicant reduction of these nontariff measures often means a major domestic policy reform which would affect imports from all countries. For either the United States or Canada to consider major domestic reforms for a particularcommodity, the other country would have to be the dominant foreign supplier (or potential supplier) and the concessions from the other trading partner would have to be significant.

Thus, the scope of the FTA was largely restricted to the reduction of bilateral trade barriers while keeping domestic agricultural programs in tact. The third mitigating factor is the size of the countries. For Canada as a small country, allowing greater US imports means major changes; for the United States Canadian concessions mean little. The United States will not make major changes in its domestic agricultural policies--particularly those which would affect head-to-head competition with Canada in third country export markets--on the basis of Canadian concessions on agriculture. Domestic policy changes in agriculture for both countries will have to await an agreement in the GATT.

Table 1: 1987 Cash Receipts for Major Agricultural Commodities for the United States and Canada.

	United States		Canada	
	Cash Receipts	Share of Total	Cash Receipts	Share of Total
Commodity	Mil US $	Percent	Mil Can $	Percent
Wheat	4868	3.53	2571	12.33
Rice	1042	.75		
Corn	8806	6.38	411	1.97
Barley	782	.57	507	2.43
Oats			49	.24
Oilseeds	10800	7.82	969	4.65
Cotton	4027	2.92		
Fruits	7869	5.70	324	1.55
Vegetables	9223	6.68	579	2.78
Tobacco	1827	1.32	259	1.24
Cattle	33829	24.50	3757	18.02
Dairy	17829	12.91	3166	15.19
Hogs	10326	7.48	2120	10.17
Sheep	560	.41	34	.16
Poultry	8210	5.95	986	4.73
Eggs	3177	2.30	487	2.34
Other	14918	10.80	4629	22.20
Total	138093	100.00	20848	100.00

Table 2: Commodity Structure of U.S. Agricultural Trade, 1987

Commodity	Exports Value	Exports Share of Total	Imports Value	Imports Share of Total
	Mil U.S. $	Percent	Mil U.S. $	Percent
Wheat	2877	10.33	35	.17
Flour & Prod.	239	.86	0	.00
Rice	551	1.98	0	.00
Feed Grains	3752	13.47	692	3.35
Other Feeds	1455	5.22	0	.00
Oilseeds	4408	15.82	56	.27
Oilseed Prod.	1885	6.77	523	2.53
--Total Row Crops	15167	54.44	1306	6.33
Fruits & Nuts	2235	8.02	2859	13.85
Vegetables	1174	4.21	1509	7.31
Animals, Live	331	1.19	610	2.96
Meats	1300	4.67	2797	13.55
Oth. An. Prod.	2299	8.25	682	3.30
Dairy Prod.	490	1.76	848	4.11
Poultry & Prod.	594	2.13	112	.54
--Total Livestock	5014	18.00	5049	24.46
Other	4269	15.32	9919	48.05
Total	27859	100.00	20642	100.00

Table 3: Commodity Structure of Canadian Agricultural Trade, 1987

Commodity	Exports Value	Exports Share of Total	Imports Value	Imports Share of Total
	Mil Ca. $	Percent	Mil Ca. $	Percent
Wheat	3224	36.28	0	.00
Flour & Prod.	266	2.99	209	3.09
Rice	0	.00	50	.74
Feed Grains	555	6.25	37	.55
Other Feeds	225	2.53	139	2.05
Oilseeds	735	8.27	144	2.13
Oilseed Prod.	223	2.51	350	5.17
--Total Row Crops	5228	58.83	929	13.73
Fruits & Nuts	156	1.76	1647	24.34
Vegetables	432	4.86	883	13.05
Animals, Live	326	3.67	121	1.79
Meats	1065	11.99	488	7.21
Oth. An. Prod.	588	6.62	437	6.46
Dairy Prod.	145	1.63	143	2.11
Poultry & Prod.	56	.63	122	1.80
--Total Livestock	2180	24.53	1311	19.37
Other	890	10.02	1997	29.51
Total	8886	100.00	6767	100.00

Since neither side had much incentive to really tackle domestic farm programs in the context of a bilateral agreement, what was agreed to and why? Have there been any specific impacts of the agreement, given the limited time it has been in effect? First, some brief background information is given on the FTA and agriculture.

General Overview of the FTA

Bilateral agricultural trade was about $5 billion, with the U.S. having a $500-million dollar surplus. Major U.S. farm exports to Canada are horticultural products, especially fresh produce. For Canada, major exports to the United States are animal products, mainly live animals and red meat. The U.S. agricultural surplus shrank in the 1980's, reflecting the strengthening of the U.S. dollar between the late 1970's and mid-1980's.

The provisions of the FTA cover a wide range of commercial activity, from automobiles to wine. Besides the chapters on agriculture and wine, other provisions could also affect agricultural trade, such as the dispute settlement provisions. The agricultural provisions can be divided into 4 main areas--tariff reduction; access barriers; subsidies; and inspection/regulation (table 4).

Table 4: Agricultural Provisions in the U.S.-Canada Free Trade Agreement

Access Barriers	Tariffs
Grain Licenses (Canada)	General Tariffs
Poultry Quotas (Canada)	Seasonal Tariffs
Wine Access (Canada)	
Sugar Quotas (U.S.)	
Grain Quotas (U.S.)	
Meat Quotas (Both)	
Inspection, Regulation	**Subsidies**
Animal Health	Direct Export Subsidies
Plant Health	Western Grain Transportation Act
Meat Inspection	
Pest Control	
Veterinary Drugs	
Packaging, Labeling	
Food Additives	
Fruit, Vegetable Inspection	

Tariffs on all agricultural commodities will be removed--for most items over a 10-year period, although for some as of January 1, 1989 and others over a 5-year period. For many fresh fruits and vegetables subject to seasonal tariffs, the tariff will be allowed to "snap back" to the previous MFN level if certain price and acreage restrictions are met:

- o if for 5 consecutive days the import price is below 90 percent of the average monthly import price over the past 5 years, excluding the high and low years; and

- o planted acreage in the importing country is not higher than the previous 5-year average, again excluding the high and low years.

On access barriers, Canada agreed to remove import licenses on wheat, barley, and oats when U.S. government support levels for the 3 commodities are equal to or less than support in Canada. Both sides agreed not to reimpose trade restrictions on these commodities unless imports increase substantially as a result of changes in government support. Canada agreed to increase import quotas on chicken, turkey, and eggs equal to actual imports for the last 5 years. The U.S. agreed not to restrict imports of sugar-containing products that contain 10 percent or less sugar. Both sides agreed to exempt each other from their meat import laws. In the wine chapter, Canada will ease various import and distribution restrictions that have limited access of U.S. wines.

Concerning subsidies, neither country can use direct export subsidies to ship products to each other. Public entities are not allowed to sell products in the other country for less than the cost of purchase plus handling costs. This could affect Canada's egg marketing agency's ability to export surplus "breaker" eggs to the U.S. Canada agreed to remove rail subsidies on eligible grain and oilseed products that are exported to the U.S. through Canada's west coast ports.

On the question of inspection and regulation, the FTA establishes various working groups to work toward harmonizing regulations in the areas of plant and animal health, labeling, inspections, and veterinary drugs.

Implications of the FTA

The negotiators singled out agriculture for special treatment because of its unique character relative to the general economy; the sector is highly regulated and protected, with different rules and institutions operating for different commodities in the two countries. Harmonization of the different policies and programs, even if that had been a negotiating objective, would have been too difficult in the relatively short time allowed by U.S. legislation for the negotiations. Thus, the provisions are limited in scope and not intended to significantly affect agricultural policy or trade. It is hard to find a major theme or idea running through the agricultural chapter because the provisions focused on specific irritants or conflicts, rather than on fundamental questions of farm policy. With respect to agriculture, the FTA was "broad but not deep (8)."

It is difficult to draw strong conclusions about the "bottom line" of the impact of the FTA on agricultural trade because of the contingent nature of many provisions:

- the tariff snapback on fruits and vegetables has several conditions that must be met before it is triggered;

- Canada's grain import licenses will be removed only if U.S. support falls below Canadian support;

- the new poultry quotas may not represent additional U.S. exports if supplemental quotas are not issued; plus, the size of quotas depends on Canadian production.

- for the meat import laws, would conditions have warranted them coming into play anyway; Canada has actually invoked its law against the U.S., and the U.S. hasn't insisted on voluntary restraints on Canada since 1983.

- how will the conditions specified in the FTA work with respect to potential restraints on U.S. Section 22--that is, what is a substantial change in support programs?

The few assessments that have been done generally indicate small impacts on agricultural trade. One U.S. trade negotiator suggested the FTA might represent a 5 percent increase in total agricultural trade (2). The Economic Council of Canada estimated an increase in Canadian output of about 2 percent of the value of farm production (4). According to another study, the average U.S. duty on food products is 4.8 percent and the average Canadian duty is 8.8 percent. Evaluating only the impact of tariff removal on trade, this study estimated U.S. food exports would increase about 6 percent and U.S. imports about 5 percent (7). A more optimistic California study forecast an increase in state exports, primarily wine and fresh produce, from $425 to $1 billion (6). Even a negative assessment from the Ontario Government estimated losses for the province of only about 2 percent of current farm cash receipts (5).

A "sleeper" underlying any estimated impacts on trade is the exchange rate. The Canadian dollar has been appreciating since the end of 1986. Even with the shifting agricultural trading environment of the 1980's and many policy changes, the importance of exchange rate changes in influencing trade is clear and will likely outweigh the sum total of the agricultural provisions of the FTA.

The impact of the FTA in the U.S., either real or perceived, has been negligible. Within the limited scope of the FTA, opportunities are greater for Canada as a small country facing a large country, but so will be the adjustment costs. The FTA has already put some pressure on Canada to make policy changes, and others are likely. The brunt of any adjustment will fall on Canada, with little impact likely on U.S. industries or farm programs. This result could indicate that many Canadian trade barriers are in fact more "trade distorting" than U.S. barriers.

Immediately following the signing of the FTA, Canada moved to place yogurt, ice cream, and other dairy products on its Import Control List, meaning an import license was required. This action was prompted by the dairy industry who feared import competition from the U.S. as a result of tariff removal. The U.S. has protested this action in th GATT. The FTA also dealt a blow to the heavily-protected wine grape growers in the provinces of Ontario and British Columbia. The Canadian Federal and provincial governments put together assistance packages to compensate grape growers for taking vines out of production and for future loss of income.

Canada has recently made minor changes in grain policy, at least partly in response to the FTA. The two-price wheat policy, which kept domestic price high, was changed as of August 1988. The price premium on domestic wheat has fallen and can be expected to disappear if the import licenses are removed. Interestingly, the CWB recently announced that oats will be removed from its jurisdiction as of the 1989/90 marketing year. With the general expectation that the licenses would likely be removed on oats because of lower U.S. support levels, did the FTA have an impact on the decision?

Some Canadian food processors are concerned that as tariffs come down, products not protected by import quotas will not be able to compete with U.S. processed products. Canadian processors often face higher input costs because of the price setting power of marketing boards as well as overall higher operating costs because they do not have economies of scale of similar U.S. operations.

The Outlook for the FTA

The FTA has not automatically ushered in a new era of harmonious trade relations. Despite the passage and early stages of implementation, trade disputes continue to proliferate. Canada has recently placed antidumping duties on U.S. sour cherries and red delicious apples; the U.S. has initiated a countervailing duty (CVD) case against pork and recently applied a temporary duty. The GATT dispute on dairy products continues. Ontario's implementation of the wine provisions continues to be problematic. How will the dispute settlement mechanisms work out? Will the current CVD's on hogs and corn be appealed? There is talk that up to 20 cases will be appealed to the new dispute settlement panel. Is this what "free trade" is all about?

How is the FTA viewed from third countries and how does it fit into the current GATT negotiations? The GATT talks probably acted both to restrain the scope of the bilateral agricultural negotiations and as an impetus to achieve something, no matter how small. Neither side wanted to make major concessions to each other that would have reduced their bargaining chips in the multilateral talks, especially since both countries maintained that the real culprits in international agricultural trade were the EC and Japan (although there are plently of Canadian farmers who think the EEP program has been very damaging to world prices). On the other hand, for two relatively friendly, open countries to admit defeat on negotiating something on agriculture would have sent a bad signal to the international community. Thus, the limited agreement on agriculture was not surprising.

The FTA has had an impact on the world economic community, at least in terms of influencing perceptions if not yet the actual workings of the world economy. Coupled with movement by the EC toward integration in 1992 and the growing economic power of the Asian Pacific countries, the "North American" market is now a reality; can one legitimately ask if the world economy is moving toward regional economic blocks and away from the mulitilateral trading system? If the current GATT talks fail to provide meaningful results for the current ills affecting world trade, will the U.S. and Canada move closer together, perhaps bringing Mexico in with them? Or is the FTA an anomoly, reflecting the unique historical and geographical relationship between the U.S. and Canada?

The FTA not only leaves many unanswered questions about the impact of the agreement but also creates new questions relating to the interpretation and implementation of the agreement. How will harmonization of regulation and inspection procedures proceed, and how will costs and benefits accrue to the affected sector?

There are also third-country effects to consider. Australia has complained that the FTA violates a Canada-Australia agreement that calls for equal treatment with respect to tariffs. Australia is currently worried about its canned fruit exports to Canada as bilateral tariffs come down.

Clearly, the U.S.-Canadian Free Trade Agreement has raised more issues than it has settled. Although there promises to be a number of disputes arising between the two countries--both because of and in spite of the agreement--substantive reform in agricultural policies will only come from a multilateral agreement. Both countries and their trading partners recognize this.

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Abstract

Title: Implications of the U.S.-Canadian Free Trade Agreement for U.S. Food and Agriculture: A Western Perspective

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A growing body of literature exists on the anticipated effects of the Free Trade Agreement (FTA) on the food and agriculture sectors of the U.S. and Canada. While some authors are skeptical that there will be any significant impacts, most are optimistic that the FTA will result in net benefits on both sides of the border. Following a review of existing writings, we argue that a clear distinction must be made between changes in economic activity resulting from the FTA and changes in patterns or volume of trade.

Our paper focuses on agriculture, forestry and fishery products, especially those important in the West, and addresses the implications of the FTA where there is intra-industry trade between Canada and the U.S. --including the case of simultaneous trade in inputs and outputs in the same industry-- and third country effects. The analytical framework is comparative statics and partial equilibrium in nature, with results linked to actual trade flows, tariff structures, and removal of tariff and non-tariff trade barriers for important Western natural resource-based products.

We conclude that the implications differ for final versus immediate goods and across industries, depending upon the trade, tariff and third country circumstances prevailing before the FTA. Further, we find support for our argument that economic activity and trade may not always be expected to move together as a result of the FTA. Finally, we discuss the importance of macroeconomic factors and domestic agricultural and resource management policies in determining the market outcomes for the goods in question and argue that decisions made in the policy sphere may well swamp any potential benefits and losses resulting from the FTA.